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# ECONOMIC OVERVIEW

## HEARINGS

BEFORE THE

## COMMITTEE ON APPROPRIATIONS
## UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

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## SPECIAL HEARINGS

**Budget of the U.S. Government**

S181-47

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# ECONOMIC OVERVIEW FOR FISCAL YEAR 1986

TUESDAY, FEBRUARY 19, 1985

U.S. SENATE,
COMMITTEE ON APPROPRIATIONS,
*Washington, D.C.*

The committee met at 2:05 p.m., in room SD–192, Dirksen Senate Office Building, Hon. Mark Hatfield (chairman) presiding.

Present: Senators Hatfield, Stevens, Weicker, McClure, Cochran, Abdnor, Kasten, Mattingly, Specter, Stennis, Proxmire, Inouye, Burdick, Leahy, Sasser, DeConcini, and Bumpers.

DEPARTMENT OF THE TREASURY

OFFICE OF MANAGEMENT AND BUDGET

COUNCIL OF ECONOMIC ADVISERS

STATEMENTS OF:

HON. JAMES A. BAKER III, SECRETARY OF THE TREASURY
HON. DAVID A. STOCKMAN, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET
WILLIAM A. NISKANEN, MEMBER, COUNCIL OF ECONOMIC ADVISERS

OPENING STATEMENT OF CHAIRMAN HATFIELD

Chairman HATFIELD. The hearing will please come to order.

Despite the highly favorable current indicators, our continued economic stability can be in serious jeopardy if our predictions prove wrong. Dr. Rudy Penner of the Congressional Budget Office has warned if economic growth stalls, deficits could increase from $180 billion to $425 billion in just 4 years, consuming 8.7 percent of all economic output or, as we refer to it, GNP.

I think our expert panel might agree that although the immediate forecast looks favorable, there are many very dark clouds hanging just over the horizon. In total, the President's fiscal year 1986 budget request proposes substantial policy changes and restates his commitment to less human resource development and more military hardware.

Moreover, the President's budget once again calls for a line item veto that would accomplish almost nothing in our effort to reduce the deficit except to leave the impression that there are easy answers to these most difficult budget problems.

Finally, I should point out that the President's budget includes

increases in several nondefense programs. It includes user fees and proposes $500 million in additional tax cuts, all of which will have an impact on our current deficit.

This tinkering with the tax code may at some point be accompanied by a substantive tax reform code that could ameliorate inequities, simplify compliance, and make the tax code more enforceable in its entirety. I strongly believe that we should move sooner rather than later on enacting tax simplification legislation.

We will have an opportunity to discuss all of these issues and more during the course of this afternoon's hearing, and I would propose that we will hear from each of the three experts and then proceed with questions and with a time limitation of 5 minutes on the first round so that everyone can have an opportunity to ask a question.

Senator Stennis, do you have any opening remarks you would like to make?

Senator STENNIS. Mr. Chairman, I think we better move along. I have very brief remarks here that I would ask be inserted in the record at this time.

PREPARED STATEMENT

Chairman HATFIELD. Without objection, the Ranking Member of the committee, Senator Stennis, will have his remarks placed in the record at this point.

[The statement follows:]

PREPARED STATEMENT OF JOHN C. STENNIS

U.S. SENATOR FROM MISSISSIPPI

Mr. Chairman, I will be brief with my remarks. We begin this new budget cycle with a dark cloud looming overhead—that is a national debt of some $3 trillion within a few short years if our deficits continue to build at the current rate. At the current rate, we will add over $1 trillion more to the debt in just 5 years. Already, the fastest growing part of the budget is interest on this debt and it will continue to grow. With each tick of the clock, it becomes clearer and clearer that we are facing a major budgetary dilemma. We cannot continue to mortgage the future at this rate. I believe, as do many of my colleagues, that our number one priority this year should be to begin to bring our runaway national debt under control.

Gentlemen, my concern over the size of the President's budget proposals and the effect they will have on the deficit is not a new one—the continued growth of the Federal budget and the fact that our deficit has grown from $78.9 billion in fiscal year 1981 to $185.3 billion in fiscal year 1984 and is projected to be $214 billion in fiscal year 1985 is overwhelming. As I stated to Secretary Weinberger when he testified before the Senate Armed Services Committee just a couple of weeks ago, I don't believe that any facet of the Federal budget should be overlooked in our search to reduce the deficit. The time has come for us to bear down and get this thing under control.

I am very concerned about one particular aspect of this debt, that is, the dependence and vulnerability it makes for the whole economy of our country. I am concerned that a growing part of our deficits are being financed by foreigners. That means that the United States has a growing indebtedness to foreign countries and individuals and that they have a claim on us. What would happened if they would suddenly exercise that claim? Would our financial system be able to bear it and what kind of trouble would it make in our economy? This growing dependence of the United States upon foreigners has another aspect. With our high interest rates causing a strong dollar it is cheaper for U.S. businesses to buy products overseas than to make them in the United States. Some say we are having the strongest economic recovery in 30 years, but our manufac-

turing capacity is only operating at about 80 percent. Does this mean that we are exporting jobs overseas? Will we be able to recover the market and our competitive position in the future or will we lose our very ability to produce these items here?

It seems to me that this deficit and debt situation is undermining the security of our economy. It is imperative that we get this runaway situation under control to prevent increased dependence of the United States on foreigners and increased vulnerability of our economic well being to foreign manipulation. I would be interested in each of your views on these matters.

I want to thank my friend, Chairman Hatfield, for again calling this very helpful hearing.

Gentlemen, I look forward to your testimony.

OPENING STATEMENT OF SENATOR PROXMIRE

Chairman HATFIELD. Any other opening remarks?

Senator PROXMIRE. Mr. Chairman, I would like to make a short statement. I have to leave and then I will come back to ask a few questions.

I apologize for taking any time at all because I know a number of my colleagues are here to listen to witnesses whom we very much want to hear.

First I want to congratulate the three witnesses who are here on the President's proposals. Of course, like all of us, I disagree with those proposals in some respects, but in general I think they take a lot of courage. I think they are on the right track. I expect to support about 90 percent of those recommendations.

I do favor the line item veto. I do favor the balanced budget amendment. I realize there are problems with both proposals, but I think the President should persist in calling for them.

I would also like to propose that the administration consider a course that has been pursued to some extent in the House, and that is legislation that would require tax increase proposals to accompany new spending proposals of any significant size.

I think this is going to be a very exciting, interesting and tough year, and I know it is going to be very hard to accomplish what the President has proposed.

I would also like to recommend that the President use his veto, use it vigorously, use it often, and stick with it. That is the only way we can make any real progress in cutting the deficit that faces us.

Chairman HATFIELD. The Senator from Alaska?

OPENING STATEMENT OF SENATOR STEVENS

Senator STEVENS. Mr. Chairman, I just want to welcome the Secretary here for the first time and indicate that this is the first time I have heard the chairman indicate that he would welcome early rather than later action on the tax simplification program. I would hope we would be able to get into that today with the Secretary. I don't know whether it is going to be within the scope of your hearing or not, but I think it should be.

Chairman HATFIELD. Mr. Secretary, it is a pleasure to welcome you here today as Secretary of the Treasury. We worked with you on previous occasions over a 4-year period. It is good to see you in this particular role. We look forward to it.

Mr. Stockman, you are obviously an old hand up here on the Hill. We are delighted to have you here today.

Mr. Niskanen, pleased to welcome you, representing the President's Council of Economic Advisors.

PREPARED STATEMENTS

We have the full printed text of your testimony. We will incorporate that in the record in toto.

[The statements follow:]

PREPARED STATEMENT OF HON. JAMES A. BAKER, III

SECRETARY OF THE TREASURY

Mr. Chairman and Members of the Committee:

It is a pleasure to meet with you today to discuss our fiscal affairs and the tasks that lie ahead. The economy has done very well in the past year and the outlook for the future is promising. But we are faced with the need to reduce what has become an excessive rate of Federal spending. Because of that Federal spending, the prospective budget deficits that would develop in the absence of any offsetting action are far too large for our long-run economic health. We must place the Federal budget deficit on a declining path and keep it there. With your help and a bipartisan Congressional effort, I am sure that meaningful reductions in the growth of Federal spending can be achieved. Legislative action along the lines recommended in the President's Budget proposals will provide a fiscal framework within which the economy can continue to prosper.

These past four years have been marked by truly dramatic improvement in the performance of the U. S. economy. Four years ago, it was the increasingly held belief that we had lost the ability to control our economic destiny -- that inflation was out of control, that dwindling availability of natural resources would put a cap on growth; and, most worrisome of all, we were told that we had lost the innovative spirit that had propelled this economy to world leadership.

Now, confidence in our ability to meet the challenges of the future is being restored by the implementation of an economic program designed specifically to:

-- bring inflation under control,

-- free markets from the burden of unnecessary government interference,

-- restore incentives for productivity and growth,

-- and, thereby, increase opportunity for all.

That program has been remarkably successful by almost every measure of economic performance.

-- Real growth for 1984 was the highest since 1951. During the first two years of the current expansion, at a 6.0 percent annual rate, real growth has been the strongest for any expansion since the economy pulled out of the strike-depressed recession trough of late-1949 into the Korean War boom.

-- Growth of real business capital spending during this expansion has far outpaced gains during any previous postwar recovery.

-- Our economy has shown itself to be a remarkable job-creating machine. Spurred by formation of new business and by technological innovation, more than 7.3 million

jobs have been created during this recovery and expansion.

-- And even as the economy has shown this remarkable growth, inflation has stayed under control. For each of the past three years, it has not exceeded 4%. Last year, as measured by the GNP deflator, it was the lowest since 1967. And the trends of wages, oil prices, and world raw material prices all remain favorable.

I have made a promise to myself that I know I may not be able to keep. But I shall try. While I will of course contribute to the development of economic forecasts that we use for purposes of planning and analysis, I shall try to resist the temptation to offer specific, detailed, numerical economic forecasts of my own.

The economic projections underlying the budget assume continued real economic growth and a steady decline in unemployment, inflation, and interest rates.

Consistent with my promise to myself, let me say only this about the overall economic outlook. Prospects are excellent for sustained economic growth without inflation -- provided that we act promptly and responsibly to continue what we have begun. And by "we" I should emphasize that I mean to include both Houses of the Congress, as well as the Executive Branch.

There is still much unfinished business.

We must not rest with the tax rate reduction we enacted in 1981. That simply adjusted for the hyper-inflation that the economy had been experiencing before. Now we must go on, as the President has directed, to overhaul the whole tax system -- to increase fairness, simplicity, and economic growth. This element of our program is, as the President has said, of equal priority with spending control.

The printed budget document includes a number of revenue-related measures -- most of which have been submitted before. These range from tuition tax credits to enterprize zone incentives to technical provisions related to certain trust funds. The budget does not include the proposals for comprehensive overhaul of the tax system -- for, as you know, those proposals, made public on November 27, remain under review. But we believe that -- with constructive effort by all parties -- a comprehensive restructuring of the tax system could be enacted this year. And I will be having a good deal more to say about this in other contexts.

The focus of today's discussion is principally upon our printed budget, however.

Immediate steps must be taken to narrow the deficit.

Just as important as closing the deficit is the manner by which it is closed. It would be wrong to go back to our old ways of pushing up taxes, either legislatively or by bracket creep in a nonindexed system. In our view, the tax reductions of the past several years have been largely responsible for the turnaround in economic performance. This means that deficit reduction must be accomplished from the spending side.

The large deficits that we face during the remainder of the decade are due to an excessive rate of Federal spending. The

American people do not feel they are undertaxed. They want government spending brought under control.

Between 1964 and 1979, Federal outlays averaged 20-1/2 percent of GNP. Now they are in the 24 to 25 percent range. Federal outlays have virtually been living a life of their own. The President's budget proposals would restrain the rate of growth of outlays below that of the economy and shrink the outlay-GNP ratio down to the 21 percent range by the end of the decade. This would leave a deficit of less than $100 billion by 1990.

*Dealing with the deficit is going to require tough decisions, but we have to face up to them. A case in point is the revenue sharing program which is run by the Treasury Department and would be eliminated under our budget proposal. Revenue sharing has been a relatively efficient, well-run program. But with current service deficits exceeding $200 billion, the Federal Government can no longer afford revenue sharing. Stated simply, we have no revenue to share.*

*I have no doubt that there will be substantial resistance to this and every other deficit reduction measure proposal in our budget. But if we are serious about achieving our goal of deficit reduction, we have to face up to the fundamental fact that we can no longer afford to continue to allow total Federal spending to grow.*

The President's budget proposes a combination of freezes, reforms, user fees, program cuts and terminations that will achieve savings for fiscal year 1986 of a little more than $50 billion. This is calculated from the "baseline" path that spending would take if we did nothing. These reductions are sufficient to hold total spending on government programs -- that is, everything but debt service -- no higher in 1986 than in 1985. It is an ambitious target, but is achievable, without damaging the social safety net, or our continued defense rebuilding, or any essential government function.

Achievement of our target of $50 billion in reductions would accomplish two things. The deficit in 1986 would be about $40 billion less than in 1985. And, even more important, the actions taken this year will have an amplified effect in later years, resulting in annual savings of more than $100 billion by 1988. This will set the deficit on a declining path -- both in absolute dollars and, even more significantly, as a share of GNP. Under our economic assumptions, the deficit would drop from over 5 1/2 percent of GNP this year to less than 3 percent by 1988 -- on down to less than 1 1/2 percent by 1990. The exact percentages are not the issue; the important thing is the trend.

The deficit has been accommodated thus far without damage to the expansion, and interest rates have declined considerably. But "real" interest rates remain too high. We need monetary policies that will allow us to continue strong economic growth without inflation. Such policies will help get interest rates down further. At the same time, a firm, convincing policy of deficit reduction will also help keep us on a course to still lower interest rates -- while insuring that the Government, in financing the deficit, does not absorb such a large share of the nation's savings as to impair private productive investment.

Our budget proposal represents a "freeze" in total program spending. That is something that is easy for most to understand -- and to most, I think, it makes sense. There will, we know, be disagreements about what we propose specifically for one program or another. But we believe our specific proposals are thoroughly

defensible on the merits. And we look forward to working with the Congress to develop a comprehensive package that will bring the budget under control -- by freezing overall program spending for fiscal year 1986.

With good will, we believe this can be done. We are sure it is what the American people want to be done.

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PREPARED STATEMENT OF HON. DAVID A. STOCKMAN

DIRECTOR

OFFICE OF MANAGEMENT AND BUDGET

BEFORE THE

COMMITTEE ON APPROPRIATIONS

UNITED STATES SENATE

FEBRUARY 19, 1985

(I)

## THE PRESIDENT'S 1986 FREEZE PLUS BUDGET PLAN

### Baseline Assumptions

- The nation is facing unprecedented structural deficits which must be decisively corrected to maintain a healthy financial system and continued non-inflationary economic growth.

- The Budget estimates assume this policy correction will be made and that the economy will move along a path of 4% real growth, 4% inflation and steadily falling unemployment and interest rates over the next several years.

- The magnitude of the required fiscal correction is enormous. Without policy changes, baseline spending will average 24.4% of GNP, and current law revenues 19% of GNP -- leaving a structural deficit in excess of 5%:

| | Current Services Baseline | | |
|---|---|---|---|
| | 1986 | 1987 | 1988 |
| Budget Totals (billions) | | | |
| o Outlays | $1,024 | $1,109 | $1,200 |
| o Receipts | 794 | 864 | 952 |
| o Deficits | $-230 | $-246 | $-248 |
| Share of GNP (%) | | | |
| o Outlays | 24.4% | 24.4% | 24.4% |
| o Receipts | 18.9% | 19.0% | 19.3% |
| o Deficits | -5.5% | -5.4% | -5.0% |

- While large deficits can be financed without serious dislocations during the early stages of recovery, they generate increasing financial strains and costs as the recovery matures. Fiscal Year 1986 will be the fourth year since the bottom of the business cycle. The following comparison with the fourth year in the prior two cycles indicates that the dimensions of the baseline deficit are unprecedented and the potential absorbtion of net private savings would be 3 to 10 times greater than in prior cycles.

| | FY 1974 | FY 1979 | FY 1986 Baseline |
|---|---|---|---|
| o Deficit share of GNP | .4% | 1.7% | 5.5% |
| o Deficit share of net private savings | 6% | 26% | 67% |

(II)

President's Freeze Plus Budget Plan

- The 1986 Budget reduces spending by $51 billion in 1986, $239 billion over 3 years and $507 billion over 5 years. If the recommended freezes, reforms, cuts and terminations are adopted, the Federal spending claim on GNP, the deficit level, and the deficit burden on the financial system will all decline dramatically over the next several years:

| | Impact of 1986 Budget | | | | | |
|---|---|---|---|---|---|---|
| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 |
| o Spending cut from Baseline (billions) | $1 | $51 | $83 | $105 | $125 | $143 |
| o Spending share of GNP ..... | 24.8% | 23.2% | 22.6% | 22.2% | 21.4% | 20.9% |
| o Deficit level (billions) ..... | $-222 | $-180 | $-165 | $-144 | $-107 | $-82 |
| o Deficit share of GNP ..... | 5.7% | 4.3% | 3.6% | 2.9% | 2.0% | 1.4% |

- The massive spending reductions required to restore fiscal balance require a fundamental reappraisal of the entire range of Federal spending commitments. The Administration's review resulted in 7 major initiatives to shrink baseline spending commitments and steadily reduce the Federal outlay claim on GNP to minimum essential levels of Government. These initiatives include:

  - Selective cost-of-living freezes excluding Social Security and means-tested benefits.
  - Across-the-board discretionary budget authority freezes in nearly all non-defense programs.
  - Major mandatory spending program reforms including student aid, veterans health care, farm price supports and Federal retirement.
  - 25 major program terminations including GRS, Amtrak, Small Business Administration, Export-Import Bank direct loans, UDAG and many others.
  - 10% cuts in all administrative expense accounts.
  - Cuts below the freeze level in desirable but lower priority programs like energy research and CDBG block grants.
  - Modest restraint of about $10 billion per year in the nation's defense build-up while maintaining all programs essential to national security.

(III)

Spending Reduction as the First Resort

- The President unequivocally pledged to the American people that he would not raise taxes to solve the deficit and received an overwhelming mandate for that position. The democratic electoral process has thus decisively resolved Washington's 3-year long philosophical debate about tax increases vs. spending reductions. The immediate, overwhelming and exclusive priority must now be on fashioning a far-reaching spending reform and reduction program sufficient to steadily shrink the Federal deficit. Moreover, this premise is validated by the larger view of our present fiscal situation.

- Twice in this decade the American people have rejected rising tax burdens: in 1980 they voted against bracket creep and in 1984 against the Mondale plan. These strong electoral preferences point to the pre-1980 levels of Federal spending and taxing as appropriate targets for fiscal policy. Compared to the 1962-1980 tax and spending benchmarks, it is clear that the 1986-88 structural deficit is rooted in the spending side of the equation:

| | 1962-1980 Actual | 1986-1988 Baseline | 1986-1988 Excess |
|---|---|---|---|
| o Federal taxes as percent of GNP ..... | 18.9% | 19.1% | .2% |
| o Federal spending as percent of GNP (baseline) | 20.6% | 24.4% | +3.8% |

- These 1962-80 benchmarks also help clarify the tax debate of the last four years. Given the rising 1980's spending claim on GNP, the original 1981 tax cut clearly went too far. Under current GNP and income assumptions, the 1981 act would have generated revenues barely equal to 17% of GNP -- well below the 1962-80 benchmark norm and clearly inadequate with spending at 24-25% of GNP levels. The five 1982-84 tax bills were therefore essential to restore the revenue base to at least the status quo ante. The nearly $300 billion increase over 1986-88 resulting from these revenue raising bills increased the tax claim by nearly 2.5% of GNP compared to the ERTA levels.

| | 1986 | 1987 | 1988 |
|---|---|---|---|
| 1981 ERTA Policy | | | |
| o Receipt levels with 1981 ERTA policy (billions) | $715 | $765 | $836 |
| o Receipt share of GNP ..... | 17.0% | 16.8% | 17.0% |
| 1982-1984 Revenue Bills | | | |
| o Increase to ERTA levels (billions) ..... | +$80 | +$99 | +$116 |
| o Increase as percent of GNP ..... | +1.9% | +2.2% | +2.4% |
| 1986 Current Services Receipts | | | |
| o Receipt level (billions) ..... | $794 | $864 | $952 |
| o Share of GNP ..... | 18.9% | 19% | 19.3% |

(IV)

- The Federal revenue base has now been fully restored to the level where the American people have drawn the line. Policy action to close the deficit must now shift back to the spending side of the equation as the priority of first resort.

Federal Spending: Where's the Excess?

- The Administration's Budget leads the way on spending reductions as the first resort: the current 24-25% of GNP level is reduced to 20-21% of GNP range by the end of the decade -- a target fully consistent with the 1962-80 average of 20.6%. However, the composition of that spending envelope is already being sharply contested by those who insist it contains too much defense spending and too little domestic spending.

- History proves nothing per se about the too much/too little debate. Spending priorities for 1986-90 must be based on a hard assessment of our current requirements for national security and the present needs of domestic welfare. But historical benchmarks demonstrate which side of the spending ledger is claiming more than before and where the heaviest burden of proof lies.

- As shown below, the 6.8% of GNP defense baseline spending level for 1986 is well below the 8-9% pre-1980 average -- except for the post Vietnam years of 1974-1980. But by 1980, an overwhelming Bipartisan consensus had concluded these levels were dangerously inadequate and supported 5 straight years of substantial real growth in defense resources. Given the continued build-up of Soviet military power, there is little basis to claim that defense spending at 7% of GNP or less is significantly out-of-line.

- The post-1970 figures for domestic and net interest claims on GNP illuminate the essence of our present fiscal dilemma. When defense spending collapsed during the 1970's from nearly 9% to barely 5% of GNP, the entire spending envelope was backfilled with an explosion of new domestic spending commitments. By 1980, non-defense programs claimed nearly 16% of GNP -- a 60% larger share than in 1966-70, while total spending rose by less than 3 percentage points of GNP. The 1970's were thus a political and fiscal paradise: in real terms, domestic spending by 1980 was nearly $300 billion above its 1970 level without a significant tax increase and without serious fiscal imbalance.

- In the 1980's, the paradise became purgatory: as the military build-up pushed the defense claim up part-way toward pre-1970 levels, the domestic claim receded only slowly despite substantial budget reductions and spending reforms in 1981-82. As a result, unprecedented deficits were realized during 1982-85 which raised the debt service burden to 3.5% of GNP or more than double its pre-1975 claim. Total spending is now 24% to 25% of GNP and must be sharply reduced if fiscal balance is to be restor ' and historic tax burden levels maintai-d.

(V)

- The burden of proof on where to make the large reduction is clear: defense at around 7% of GNP is not too high unless it can be convincingly shown that current budget levels exceed true requirements. Domestic spending at 14% of GNP is still too high unless it can be shown that the current claim is essential to national well-being and constitutes the minimum essential size of government:

Spending Claims on GNP

| | Pre-Vietnam 1962-65 | Vietnam Era 1966-70 | 1970's Defense Collapse 1973 | 1970's Defense Collapse 1980 | 1985 Actual | 1986 Baseline |
|---|---|---|---|---|---|---|
| o Defense (DOD)..... | 8.5% | 8.9% | 6.1% | 5.2% | 6.6% | 6.8% |
| o Non-defense ..... | 9.2% | 10.0% | 12.2% | 15.8% | 15.0% | 14.1% |
| o Net interest ..... | 1.3% | 1.4% | 1.4% | 2.0% | 3.4% | 3.5% |
| o Total spending .... | 19.0% | 20.1% | 19.6% | 22.9% | 24.8% | 24.4% |

Defense Spending is Not Out of Line: Some Hard Questions for Freeze Advocates

- The Administration's $314 billion 1986 defense request does not embody a totally new, novel and radical plan secretly cooked up in the Pentagon since Congress last visited the issue four months ago in the FY 1985 Appropriations Bill. It is precisely the opposite: it mostly represents "old business" -- the 1986 funding installment of a wide range of policy requirements -- force structure, pay levels, operations and readiness, weapons modernization programs and global military missions and capabilities -- which have been debated and endorsed by the Congress over the past 5 years. There is practically nothing "new" in it.

- Those who loudly advocate a defense budget authority freeze are playing Rip Van Winkle: after five years of voting for nearly all of the program elements which drive the 1986 budget cost, they now shout -- "The number is too big." But they have not explained which previously accepted weapons systems they want to cancel; which approved missions they would forego; which elements of the force structure they would deactivate; or which readiness and pay accounts they would underfund. Yet a budget authority freeze would require some or all of these explicit reversals of prior Congressional policy. In effect, freeze advocates are arguing with their own records as a brief review of defense spending trends since 1980 clearly demonstrates.

(VI)

- Congress has appropriated $1.2 trillion for defense over the past 5 years -- 95% of the Administration request:

| | 1981 | 1982 | 1983 | 1984 | 1985 | Total |
|---|---|---|---|---|---|---|
| | | | (Dollars in billions) | | | |
| o Request | 177.1 | 221.8 | 257.5 | 273.4 | 305.0 | 1,234.8 |
| o Enacted | 178.4 | 213.8 | 239.5 | 258.2 | 284.3 | 1,174.2 |
| o Percent enacted | 101% | 96% | 93% | 94% | 93% | 95% |
| o Real growth rate | 12.7% | 12.2% | 7.6% | 4.4% | 5.8% | --- |

- Most of the proportionately small Congressional amounts cut have involved bookkeeping, pricing and pacing issues -- trims which do not significantly lower the long-run cost of the approved program and the major cost-driving elements within it. The $21 billion cut from the 1985 request for example breaks out as follows:

| Pricing and Financing Changes | Millions |
|---|---|
| o Small reduction in requested pay raises and end-strength increases | $-1,845 |
| o Fuel, stock funds and foreign currency price re-estimates | $-2,679 |
| o Navy ship procurement price re-estimates | $-716 |
| o Battleship reactiviation funded with prior year inflation savings | $-423 |
| o Contingency allowances reduction | $-168 |
| o Army helicopter price re-estimates | $-121 |
| o F-16 inflation savings and re-estimates | $-514 |
| o Peacekeeper procurement partially funded with prior year BA | $-1,500 |
| o Other inflation savings | $-805 |
| Subtotal | $-8,771 |

| Pacing and Quantity Changes | Millions |
|---|---|
| o Army missile production slow-downs | $-320 |
| o Production rate and procurement level adjustments for Army ammo support vehicles, communications, and other equipment | $-504 |
| o Navy mods, spares and ammo procurement reductions | $-345 |
| o Minor production rate adjustments in Navy missiles, torpedoes, and support equipment | $-758 |
| o Denial of Navy advanced procurement for F-18 and other aircraft | $-140 |
| o Rephasing of several ship construction programs | $-176 |
| o Air Force spares and repair parts procurement slow-down | $-628 |
| o Production rate changes for Air Force support vehicles and equipment | $-483 |
| o Air Force program deferral and production rate adjustments: | |
| -- C-5 transport, KC-135 re-engining, other aircraft mods and equipment | $-1,251 |
| -- Maverick, AMRAAM and other missiles | $-740 |
| -- Munitions and other | $-199 |
| Subtotal | $-5,544 |
| **Program Changes** | |
| o Limiting of real growth in: | |
| -- non-strategic military construction | $-1,400 |
| -- family housing | $-300 |
| -- non-strategic R&D | $-2,033 |
| o General reductions in ADP, audio-visual, consultants, travel, medical, stock funds and other | $-800 |
| o Scale-back of Strategic Defense Initiative | $-377 |
| o Cancellation of Navy TAK support ship | $-91 |
| o Delay of Sergeant York gun | $-416 |
| o Denial of full Peacekeeper procurement | $-587 |
| o Other defense-wide changes | $-181 |
| Subtotal | $-6,185 |
| Total | $-20,500 |

(IX)

1986 Cost of 33 New or Substantially Expanded Strategic and Conventional Weapons Investment Programs Since 1980

| System | 1980 Base | Enacted 1981 | 1982 | 1983 | 1984 | 1985 | 1986 Request |
|---|---|---|---|---|---|---|---|
| Strategic Systems | | | | | | | |
| 1) KC-135 re-engining | $96 | $219 | $395 | $529 | $720 | $827 | $868 |
| 2) B-1 Bomber | 70 | 260 | 2,083 | 4,787 | 6,868 | 8,192 | 6,185 |
| 3) Peacekeeper (MX) | 732 | 1,509 | 1,910 | 1,930 | 4,148 | 4,314 | 4,040 |
| 4) Midgetman | 0 | 0 | 0 | 0 | 467 | 641 | 777 |
| 5) Trident II missile (R&D) | 26 | 97 | 241 | 370 | 1,473 | 2,212 | 2,748 |
| 6) Strategic defense (SDI) | 0 | 0 | 0 | 0 | 51 | 1,397 | 3,722 |
| 7) INF: GLCM, SLCM and Pershing II | 378 | 745 | 1,165 | 1,427 | 1,569 | 1,598 | 2,439 |
| o Subtotal, Strategic Systems | $1,302 | $2,830 | $5,794 | $9,043 | $15,296 | $19,181 | $20,779 |
| 8) F-18 fighter aircraft | 1,067 | 1,921 | 2,147 | 2,470 | 2,316 | 2,500 | 2,762 |
| 9) AV-8B attack aircraft | 0 | 87 | 600 | 742 | 788 | 787 | 979 |
| 10) AH-64 helicopter | 0 | 51 | 502 | 802 | 1,192 | 1,247 | 1,234 |
| 11) SH-60B helicopter | 0 | 104 | 673 | 620 | 437 | 432 | 371 |
| 12) EH-60A helicopter | 0 | 0 | 0 | 21 | 152 | 119 | 143 |
| 13) C-5B Transport | 0 | 0 | 0 | 785 | 1,301 | 1,580 | 2,268 |
| 14) KC-10 cargo/tanker aircraft | 185 | 307 | 213 | 898 | 732 | 565 | 447 |
| 15) Army helicopter improvement program | 0 | 0 | 0 | 28 | 185 | 204 | 211 |
| 16) C-130 modification | 12 | 34 | 104 | 154 | 179 | 256 | 213 |
| 17) Attack Submarine (SSN-688) | 829 | 1,027 | 1,328 | 1,413 | 1,921 | 2,665 | 2,708 |
| 18) AEGIS Cruiser (CG-47) | 820 | 1,912 | 2,917 | 2,886 | 2,946 | 2,985 | 2,766 |
| 19) AEGIS Destroyer (DDG-51) | 0 | 0 | 0 | 0 | 79 | 1,050 | 164 |
| 20) LHD-1 Amphibious Assault Ship | 0 | 0 | 45 | 55 | 1,366 | 39 | 1,507 |
| 21) LSD-41 Dock Landing Ship | 41 | 388 | 298 | 414 | 363 | 490 | 414 |
| 22) Mine Counter Measures Ship (MCM-1) | 0 | 0 | 99 | 99 | 284 | 345 | 334 |
| 23) M-1 Tank | 651 | 1,348 | 1,405 | 1,831 | 1,720 | 1,852 | 2,109 |
| 24) Bradley Fighting Vehicle | 236 | 628 | 827 | 810 | 791 | 962 | 1,035 |
| 25) Harpoon missle | 144 | 174 | 227 | 210 | 275 | 330 | 315 |
| 26) Stinger | 88 | 85 | 249 | 268 | 183 | 279 | 364 |
| 27) HARM missile | 0 | 115 | 106 | 86 | 367 | 574 | 736 |
| 28) TOW missile | 19 | 37 | 284 | 162 | 216 | 236 | 271 |
| 29) Maverick | 4 | 0 | 221 | 285 | 336 | 463 | 726 |
| 30) Hellfire missile | 0 | 26 | 119 | 246 | 234 | 250 | 306 |
| 31) Patriot missile system | 396 | 442 | 668 | 788 | 876 | 961 | 983 |
| 32) MLRS rocket system | 65 | 115 | 178 | 369 | 526 | 541 | 549 |
| 33) Navy Standard missile | 176 | 297 | 442 | 590 | 602 | 741 | 848 |
| o Subtotal, Conventional weapons | $4,732 | $9,098 | $13,652 | $17,032 | $20,367 | $22,453 | $24,763 |
| Grand total, Strategic/Conventional | $6,034 | $11,928 | $19,446 | $26,075 | $35,663 | $41,634 | $45,542 |
| Annual real growth rate | -- | [illegible]% | 51.9% | 26.5% | 30.0% | 11.0% | 4.1% |

(X)

- The 1986 operations and readiness/sustainability - related request is consistent with the funding path Congress has approved for five straight years:
  - Total funding in the enacted 1985 bill was $40 billion above the 1980 base. The additional $5 billion in the 1986 request is consistent with the approved path.
  - The 1986 requested real growth of 3.7% for O & M is well below the 6.4% 1981-85 average.
  - Real growth rates for replenishment of spares and ammunition are also modest compared to 1981-85.
- A freeze would require reduction in flying hours, steaming days, training time, depot maintenance, spare parts availability and other force operations. Freeze advocates have not analyzed or explained the consequence of cuts in this area:

| | 1980 Base | Enacted 1981 | 1982 | 1983 | 1984 | 1985 | 1986 Request |
|---|---|---|---|---|---|---|---|
| Operations and Maintenance | | | | | | | |
| o Budget level (billions) ..... | $46.6 | $55.2 | $62.0 | $66.7 | 71.0 | 78.2 | 82.4 |
| o Real growth rate (%) | -- | 8.0% | 8.1% | 4.6% | 4.8% | 6.6% | 3.7% |
| Replenishment Spares | | | | | | | |
| o Budget authority ..... | $1.5 | $3.3 | $4.6 | $4.7 | $5.5 | $6.1 | $6.2 |
| o Real growth rate ..... | -- | 96.4% | 27.9% | -4.1% | 12.3% | 3.7% | -2.2% |
| Ammunition | | | | | | | |
| o Budget level ..... | $1.7 | $2.2 | $4.2 | $3.7 | $4.3 | $5.4 | $6.1 |
| o Real growth ..... | -- | 17.6% | 73.7% | -13.7% | 12.1% | 21.0% | 6.3% |
| Total, Operations, Spares, Ammunition | | | | | | | |
| o Budget level ..... | $49.8 | $60.7 | $70.8 | $75.1 | $80.8 | $89.7 | $94.7 |
| o Real growth ..... | -- | 11.6% | 12.2% | 27.0% | 5.7% | 7.3% | 3.5% |

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- The 1986 request for military personnel essentially reflects the end-strength and force structure enhancement approved since 1980 along with prior year catch-up pay increases:
  - Through 1985 Congress approved end-strength increases of 102,000 or 5% -- to permit activation of new units and fill-out of existing units
  - Cumulative pay raises of 43.6% to restore competitiveness, recruitment, retention and morale
- The resulting $28 billion in military personnel cost increases through 1985 is now locked into the base. Since the planned 1986 pay raise is only 3.0%, significant savings would require reversing 1981-85 policy decisions and de-activiation of selected units.

Military Personnel Costs

| Measure | 1980 Base | Enacted 1981 | 1982 | 1983 | 1984 | 1985 | 1986 Request |
|---|---|---|---|---|---|---|---|
| o Budget level (billions) ..... | $41.1 | $48.5 | $55.7 | $61.0 | $64.9 | 68.9 | $73.4 |
| o Active duty end-strength (000). | 2,050 | 2,082 | 2,109 | 2,123 | 2,138 | 2,152 | 2,178 |
| o Pay raise (%) ..... | --- | 11.7% | 14.3% | 4.0% | 4.0% | 4.0% | 3.0%* |
| o Nominal budget growth (%) ..... | --- | 18.0% | 14.8% | 9.5% | 6.4% | 6.2% | 6.5% |

* Effective 1 July 1985

- Congressional appropriations for conventional R&D nearly doubled between 1980 and 1985 -- reflecting a consensus policy objective of maintaining the superiority of the U.S. military technology base. While the 1986 increase is larger than in prior years, it embodies significant funding growth for previously approved projects that are moving into a mature phase of development cycle. Examples include the C-17, JSTARs, JVX and the Advanced Tactical Fighter. A budget authority freeze would severely disrupt dozens of programs essential to future security requirements:

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Conventional R&D

| | 1980 Base | Enacted 1981 | 1982 | 1983 | 1984 | 1985 | 1986 Request |
|---|---|---|---|---|---|---|---|
| o Budget level (billions) ..... | $11.0 | $12.8 | $15.1 | $16.8 | $18.8 | $21.6 | $26.9 |
| o Real growth ..... | --- | 6.8% | 11.5% | 6.9% | 8.4% | 10.4% | 19.9% |

- The above four categories account for more than 75% ($133 billion) of the total DOD budget authority growth ($175 billion) between the 1980 base and the 1986 request. Dozens of major program and policy decisions have been ratified by Congress over the intervening 5 years, and these elements drive the 1986 funding level. While the linkage of any single item to objective national security requirements is always a fair topic for debate, the cumulative weight of executive and legislative branch scrutiny, analysis and debate places a strong burden on those who would radically disrupt the funding build-up path.

- To achieve a 1986 budget authority freeze would require cutting the Administration's request in these accounts alone by nearly $19 billion. This cannot be done exclusively through reform and economizing -- steps which yield savings only in the very long-run and of far smaller magnitude than commonly supposed. Freeze advocates must therefore propose to do more than cut the number -- they must demonstrate which previously approved systems, programs, capabilities and forces they would delete in order to reduce the funding requirement for 1986 and future years.

- Congress will undoubtedly trim small amounts from the 1986 request as in past years -- reflecting repricings, financing adjustments, modest program deferrals and the like. But as previously shown, the main cost-driving elements have been strongly ratified and will remain in place. These policies will lift the defense claim on GNP slightly above 7% over the next several years -- a figure which is not "too high" given the consensus view of current requirements embodied in the 1980-85 build-up.

Domestic Spending is Still Too High: Where the Reductions Can Be Taken

- The 1986 baseline for non-defense spending would total nearly $593 billion or 14.1% of GNP if fully funded. Baseline outlays can be divided into three basic categories for purposes of analysis:
  - $289 billion for social contract expenditures in Social Security, Medicare, unemployment insurance and related smaller programs
  - $92 billion for means-tested safety net programs and related social service support activities targeted on low-income populations
  - $211 billion for all of the other public sector functions of the Federal government -- old, new, valid and questionable.
- Significant reductions in social contract expenditures would violate explicit commitments -- both from the distant and more recent past -- to nearly 40 million elderly, disabled or unemployed Americans, and would undermine their basic financial and social well-being. The savings proposed in the President's budget, therefore, are modest compared to the baseline cost and are achieved primarily through Medicare provider freezes and small changes in beneficiary eligibility and cost-sharing requirements. They contribute just 8% of the total budget savings proposed for 1986-88.

Social Contract Expenditures: Social Security/Medicare/Unemployment and Related

| Program Basis | 1986 | 1987 | 1988 |
|---|---|---|---|
| o Baseline spending level (billions) | $289.3 | $310.4 | $333.9 |
| o Medicare freezes/reforms | -4.1 | -6.3 | -8.2 |
| o RR/Black Lung COLA freezes | -0.1 | -0.2 | -0.3 |
| o President's 1986 Budget level | $285.1 | $303.9 | $325.4 |
| o Social contract savings as % of total Budget savings | 8% | 8% | 8% |

- In combination with reforms implemented during 1980-85, these measures will result in a steady decline of the social contract claim on GNP without violating existing commitments:

Social Contract Share of GNP

| 1980 | 1985 | 1986 | 1988 | 1990 |
|---|---|---|---|---|
| 6.5% | 7.1% | 6.8% | 6.6% | 6.5% |

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- The means-tested safety net programs and related social service activities were substantially reformed in 1981-82. Only highly selective, targeted reforms and cuts are proposed in the 1986 Budget.
  - 90% of baseline spending is retained and 90% of total budget savings occur in other components of the budget.
  - No changes are proposed for major safety net programs including food stamps, WIC and SSI.
  - Major social services programs including disadvantaged and handicapped education, social and health services block grants, older Americans and Head Start programs and employment and training grants are subject only to the across-the-board freeze on 1986 budget authority.
  - Targeted reforms are proposed for the following programs: caps on Medicaid reimbursement to the states while maintaining beneficiary entitlement protections; elimination of the 22¢/lunch subsidy for families above $19,000; subsidized housing new unit moratorium and vendor payment reforms while fully supporting the existing 11 million low-income tennants; workfare and minor household reforms in AFDC; and elimination of 4 high-cost or outmoded social programs -- legal services, community services, Job Corps and the weatherization program (phase-out through 1990).

PREPARED STATEMENT OF WILLIAM A. NISKANEN
MEMBER
COUNCIL OF ECONOMIC ADVISERS

## THE ECONOMIC OUTLOOK

Thank you, Mr. Chairman. I am pleased to present the Administration's economic outlook before this distinguished Committee.

### The Outlook for 1985-1990

The Administration's economic projections for 1985 through 1990 are shown in the attached table. Our general economic outlook is that the economy can produce fairly rapid growth in real GNP and employment over the next 6 years without an acceleration in inflation.

Real GNP growth is expected to average 4 percent per year from the fourth quarter of 1984 through the fourth quarter of 1988, and then slow to 3.6 percent by 1990. The projected growth in output will be accompanied by large gains in employment. Employment growth is projected to average nearly 2 percent per year over this period, so that by 1990 employment is expected to increase by about 12.7 million. Growth in the labor force is expected to be somewhat slower, leading to a

gradual decline in the unemployment rate to 5.8 percent by 1990.

Inflation is expected to increase slightly in the near term -- to 4.3 percent by 1990. The assumed increase next year is due to cyclical factors, and a smaller contribution of special factors such as the exchange value of the dollar. Price performance in this recovery has been surprisingly good. Another year of lower than expected inflation in 1985, of course, is possible and would be most welcome.

For budget planning purposes, we assume that the Treasury bill rate will average 8.1 percent in 1985, and gradually decline to 5 percent by 1990.

The Administration's economic assumptions for 1985 and beyond represent conditional forecasts based on overall monetary and fiscal policy assumptions. Specifically, the projections assume that the Federal Reserve will maintain M1 growth within its tentative target range for 1985, with a gradual reduction of money growth in subsequent years, and that the Congress will approve the reductions in growth of Federal outlays proposed in the Administration's FY 1986 budget. The assumed declines in interest rates, in particular, will depend importantly on the credibility of our commitment to these

policies. In addition, the forecasts are based on the current tax code, and would need to be changed if there is a substantial revision in the code. Finally, the projections for 1985 summarize our estimate of conditions during this year, but the projections for 1986-1990 reflect our forecast of trend conditions over that later period.

The Administration's projections for real growth in the 1986-90 period are higher than most private forecasts, but I believe that optimism is justified given current conditions. The performance of the economy in 1984 was impressive. From 1983-IV to 1984-IV, real GNP increased 5.6 percent, employment increased 3.1 percent, and productivity in the business sector increased 3.1 percent. The civilian unemployment rate declined from 8.2 percent in December 1983 to 7.2 percent in December 1984. The growth of output and the final installment of the reduction in personal income tax rates initiated in 1981 led to a 5.7 percent increase in real disposable income. The current economic recovery has been the strongest in 30 years.

Moreover, the strength of the real economy was achieved in an environment of stable inflation. The broader price indices increased only 3.5 to 4 percent in 1984, about the same as in

1983. This is the lowest general inflation rate since 1967. Low inflation is one of the reasons I am optimistic about the economic outlook. Recessions that have occurred in the past have usually been preceded by monetary restraint that was necessary to brake accelerating inflation. A continuing commitment to policies that gradually reduce inflation over time is, therefore, important to sustaining the economic expansion.

Several factors may lead to relatively rapid near-term growth. At the current time, the composition of real GNP growth is quite favorable. Real final sales increased rapidly in the fourth quarter, reducing the growth in inventories and permitting a decline in the ratio of inventory to sales. Capacity utilization rates in manufacturing generally remain below prior peaks, and strong incentives exist for fairly rapid growth in investment. We anticipate continued rapid growth in real final sales in the first half of 1985, which will lead to additional inventory accumulaton in the second half.

Over the longer term, projected growth in real GNP at 4 percent is based on the assumption that both employment and productivity will increase at an average rate of about 2 percent. The forecast for employment is somewhat higher than the postwar experience, but is consistent with projected trends

in labor force growth and the projected slow decline in the unemployment rate. The forecast growth of productivity is about equal to the postwar average - slightly lower than the experience of the past 4 years, but well above the poor performance of the 1970s. Although predicting productivity trends has proved to be difficult, I believe that this is a sensible projection. Shifts in the composition of the labor force are favorable, the capital stock is beginning to grow rapidly, and Federal policies are now directed toward improving productivity rather than retarding it.

The economy in 1984 provided additional evidence that the changes in tax policy introduced in 1981 and 1982 had a positive influence on the current economy recovery. Reduced marginal tax rates contributed to the strong growth of the labor supply and productivity. The combined effect of the change in depreciation allowances initiated in 1981 and lower inflation contributed to the 16.6 percent increase in domestic business investment. The contribution of real business fixed investment to the growth of real GNP in the current recovery has been three times its contribution in the typical recovery. Real business fixed investment is now a higher share of real GNP than at any time in the postwar period. It is clear that

the structure of the tax system, for any given level of tax receipts, has important effects on labor supply, capital formation, and productivity growth.

Serious distortions and impediments to economic growth remain in the current tax system. The Administration strongly supports reform of the system to reduce these problems. However, the economic cost of government expenditures depends importantly on marginal tax rates. The relative size of government may be constrained by this cost. If the size of government is already too large as a result of biases in the political process, then a tax reform that lowers tax rates should probably be accompanied by constitutional and legislative restraints on growth in government expenditures.

To conclude, the Administration's economic projections provide a basis for long-term budget planning. Our projections are conceptually different from the forecasts of private economists. Private forecasters must assess the prospects for enacted policy in addition to economic conditions in developing their forecasts. Our job is to make projections on the basis of what can happen given responsible policies, and to see that those policies are carried out. Good policy is always more important than good forecasts.

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Impact of 1986 Budget on Means-Tested Safety Net Programs and Related Social Service Programs

| Program | 1986 | 1987 | 1988 |
|---|---|---|---|
| | | (Dollars in billions) | |
| **Means-tested benefits funded at current services: SSI, Food Stamps, WIC, Other Nutrition, EITC and Refuge Aid** | | | |
| o Current services baseline | $24,532 | $25,372 | $27,087 |
| o 1986 Budget savings | +8 | -10 | -28 |
| **Social Service Programs Funded at Freeze Level*** | | | |
| o Current services baseline | $19,023 | $19,703 | $20,289 |
| o One-year BA freeze savings | -328 | -791 | -1,085 |
| **Targeted Reforms or Cuts in Selective Programs** | | | |
| o Current services baseline | $48,385 | $51,547 | $55,134 |
| o Freeze Medicaid reimbursement in 1986 and cap out-years at MEPI | -1,000 | -2,091 | -3,202 |
| o Mandatory AFDC work fare; no independent minor households; parents benefit reform | -229 | -198 | -190 |
| o Eliminate upper income school lunch subsidy | -648 | -906 | -1,007 |
| o 2-year HUD incremental unit moratorium and vendor payment reforms | -1,567 | 1,773 | -1,939 |
| o Eliminate legal services, community services, Jobs Corps and weatherization | -564 | -777 | -873 |
| o Sub-total | -4,104 | -6,311 | -7,882 |
| **Grand Total: Means-Tested Benefits and Social Service Programs** | | | |
| o Current services baseline | $91,941 | $96,623 | $102,509 |
| o Proposed savings | -4,426 | -7,114 | -8,997 |
| o Percent reduction from baseline | 5% | 7% | 9% |
| o Share of total budget savings | 9% | 9% | 9% |

* Disadvantaged and Handicapped Education; Employment and Training Block Grants; Older Americans Employment and Services; Head Start; Maternal and Child Health; Health and Social Services Block Grant; Foster Care; Adoption Aid and Child Welfare; Handicapped Rehabilitation and Low-income Energy.

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Other Non-Defense: What Public Sector Functions Can We Afford and Which Do We Need?

- 1986 baseline spending for all of the other public sector functions -- ranging from harbor dredging to health research -- is $211 billion. It represents the accumulation of commitments made over decades based on ad hoc rules regarding appropriate Federal activities and political responses to every manner of special interest pressure.

- We have now arrived at the day of reckoning: we can't afford it all and must make fundamental choices between where we spend and where we save. The Administration's budget does not shrink from that difficult task. It proposes to eliminate two-dozen programs and reform dozens more based on clear and consistent rules for valid and no longer affordable public sector functions.

- Savings in this budget component total $30.3 billion or nearly 80% of the 1986 non-defense total. Over five years, savings in this component total nearly $300 billion. The Administration's plan offers the first comprehensive reappraisal and restructuring of the public sector functions of the Federal government in decades based on the following principles of choice:

  - Purely local economic development subsidies and fiscal aid are no longer affordable and produce few net national benefits. These programs should be eliminated:

    - General Revenue Sharing is an efficient grant mechanism -- but is neither affordable nor makes sense given the relative fiscal health of state/local government compared to the Federal budget hemorrhage.

    - Local development subsidies including UDAG, EDA, Appalachia, TVA development, rural development and sewer grants primarily serve to intensify the competition for investment and jobs among localities in an arbitrary and nearly random manner. Localities desiring to offer subsidies to attract investment should pay for them with their own tax dollars.

    - Mass Transit capital and operating subsidies should be financed with local taxes if uneconomic investments and subsidised fares are desired. Current Federal subsidies are being siphoned off in excessive transit wages, operating inefficiencies and over-built systems. Continued subsidization is neither affordable nor fair and will not stop the decade's long decline of Mass Transit services.

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- Major benefit programs that have expanded well beyond their original purposes or promises should be pared back and reformed.
  - The cost of the veterans health care system could triple over the next fifteen years unless eligibility for free care is limited to disabled veterans and the needy. The Administration proposes an income limit of about $15,000 per year, to recover costs from the insurance companies of veterans who are served, and to gradually shift system resources away from over-built in-patient care facilities to skilled nursing and outpatient care.
  - Student grants and loans now cost $8 billion per year, go to 50% of all freshman students, and provide benefits to a wide-range of middle and upper income families. The Administration proposes to cap total benefits at $4,000 per student, eliminate the $3,000 GSL subsidy for families above $33,000, and tighten the independent student loophole. We can no longer afford to subsidize colleges in the guise of helping middle and upper income students finance "high-cost" educations.
  - The Federal Civil Service Retirement System provides the richest annuities in the nation and costs nearly $25 billion per year. The Administration proposes to phase-out overly generous early retirement, reduce the annuity calculation base (High-5) and limit COLA's for upper income annuitants.
- The time has come to curtail unjustified business, commerical or regional subsidies. The Administration's plan would eliminate or sharply pare-back unjustifiable public sector activities in the following areas:
  - Reform farm price supports and cap subsidy eligibility at $20,000 per producer and non-recourse loans at $200,000 per producer.
  - Eliminate Amtrak, the SBA and Export-Import Bank direct loans.
  - Require navigation users to pay 70% of the cost of dredging and construction services provided by the Federal government.
  - Phase-out the REA subsidized loan programs and reform the debt repayment system for Bonneville and other Power Marketing Adminstrations.

(XVIII)

COMPOSITION OF NON-DEFENSE SAVINGS
(billions)

| | 1986 | 1987 | 1988 |
|---|---|---|---|
| Social Contract | | | |
| o Baseline spending | $289.3 | $340.4 | $333.9 |
| o Savings | -4.2 | -6.5 | -8.5 |
| Safety Net and Related Social Services | | | |
| o Baseline spending | 91.9 | 94.6 | 102.5 |
| o Savings | -4.4 | -7.1 | -9.0 |
| Other Non-Defense | | | |
| o Baseline spending | 211.3 | 220.7 | 230.2 |
| o Savings | -30.3 | -50.6 | -62.2 |
| Non-Defense Total | | | |
| o Baseline spending | 592.5 | 625.7 | 666.6 |
| o Savings | -38.9 | -64.2 | -79.7 |
| o Other non-defense share of total savings | 78% | 79% | 78% |

o Impact of the Administration Plan on Non-Defense Spending Claim on GNP

| | Actual | | President's Budget | | |
|---|---|---|---|---|---|
| | 1980 | 1985 | 1986 | 1988 | 1990 |
| Social Contract | 6.5% | 7.1% | 6.8% | 6.6% | 6.5% |
| Safety Net/Social Services | 2.6% | 2.2% | 2.1% | 1.9% | 1.7% |
| Other Non-Defense | 6.6% | 5.7% | 4.3% | 3.4% | 2.9% |
| o Total Non-Defense | 15.8% | 15.1% | 13.2% | 11.9% | 11.2% |

Economic Projections for 1985-1990

| | Real GNP | | GNP Deflator | |
|---|---|---|---|---|
| | Year/Year | IV-Q/IV-Q | Year/Year | IV-Q/IV-Q |
| Calendar Year | (Percent Change) | | | |
| 1985 | 3.9 | 4.0 | 3.8 | 4.3 |
| 1986 | 4.0 | 4.0 | 4.4 | 4.3 |
| 1987 | 4.0 | 4.0 | 4.2 | 4.1 |
| 1988 | 4.0 | 4.0 | 3.9 | 3.8 |
| 1989 | 3.9 | 3.8 | 3.6 | 3.5 |
| 1990 | 3.6 | 3.6 | 3.3 | 3.2 |

| | Civilian Unemployment Rate | | 91-Day Treasury Bill Rate | |
|---|---|---|---|---|
| | Average | IV-Q | Average | IV-Q |
| | (Percent) | | | |
| 1985 | 7.1 | 7.0 | 8.1 | 8.0 |
| 1986 | 7.0 | 6.9 | 7.9 | 7.8 |
| 1987 | 6.7 | 6.6 | 7.2 | 6.7 |
| 1988 | 6.4 | 6.3 | 5.9 | 5.5 |
| 1989 | 6.2 | 6.1 | 5.1 | 5.0 |
| 1990 | 5.9 | 5.8 | 5.0 | 5.0 |

## STATEMENT OF SECRETARY BAKER

### INSERT TO PREPARED STATEMENT

Chairman HATFIELD. You may proceed, Mr. Secretary, to either summarize, highlight or however you wish to handle your testimony.

Secretary BAKER. Thank you, Mr. Chairman.

I would like, if it is all right, to give you an insert which I would like to have added to my opening statement. It would begin right after the sentence that reads "This would leave a deficit of less than $100 billion by 1990."

I would like to have inserted the following:

Dealing with the deficit is going to require tough decisions, but we have to face up to them. A case in point is the revenue sharing program which is run by the Treasury Department and would be eliminated under our budget proposal. Revenue sharing has been a relatively efficient, well-run program. But with current service deficits exceeding $200 billion, the Federal Government can no longer afford revenue sharing. Stated simply, we have no revenue to share.

I have no doubt that there will be substantial resistance to this and every other deficit reduction measure proposal in our budget. But if we are serious about achieving our goal of deficit reduction, we have to face up to the fundamental fact that we can no longer afford to continue to allow total Federal spending to grow.

I would like to have that inserted, Mr. Chairman, if it is all right with you.

Chairman HATFIELD. With no objection, that will be an insert in your formal statement.

Secretary BAKER. Thank you, sir.

[CLERK'S NOTE: The requested insert material for the prepared statement has been added, and appears in italics.]

### EXCERPT FROM PRESIDENT'S STATE OF UNION ADDRESS

Secretary BAKER. I would like to simply add this: I would like to quote a couple paragraphs, if I might, from the President's State of the Union address on February 6, wherein he said,

Four years ago we said we would invigorate our economy by giving people greater freedom and incentives to take risks and letting them keep more of what they earned. We did what we promised and a great industrial giant is reborn. Tonight we can take pride in 25 straight months of economic growth, the strongest in 34 years, a 3-year inflation average of 3.9 percent, the lowest in 17 years, and 7.3 million new jobs in 2 years, with more of our citizens working than ever before.

Mr. Chairman, it is my belief that this can continue if the Congress will enact the spending cuts which the President has requested and if the Federal Reserve will continue to pursue monetary policies permitting sustained economic growth without inflation.

Thank you, sir.

Chairman HATFIELD. Thank you, Mr. Secretary.

Mr. Stockman?

## STATEMENT OF DAVID STOCKMAN

### HIGHLIGHTS OF PREPARED STATEMENT

Mr. STOCKMAN. Mr. Chairman, members of the committee, let me, too, insert my statement in the record. It tries to provide a comprehensive overview of what is in the budget recommended by the President and the basic standards that we use to make decisions.

But I would like to take a couple of minutes to call your attention to what I think are some of the highlights. As we started to shape this 1986 budget, I think it was apparent to all that we are confronted with a true fiscal crisis, a fundamental imbalance in the budget that can't be sustained, that we are stuck spending somewhere near 24 to 25 percent of GNP, that our current tax code takes in 19 percent. If we borrowed that 5 percent difference, that would absorb more than two-thirds of all the net private savings available in the U.S. economy.

We could probably do that for awhile, at the bottom of the recession or in the early stages of a recovery, but now we are into the fourth year and the fifth year in the 1986 and 1987 budget we are working on. Clearly, it is very deleterious, and adverse economic effects have to flow unless we begin to move decisively to reduce that borrowing.

### BUDGET OF BASIC CHOICES

So as we confronted that task, it was clear that this budget for 1986 has to be a budget of basic choices, not the normal kind of housekeeping budget we do in which 90 percent of the budget runs on automatic pilot either because we take the programs for granted or because automatic entitlements are built in and we allow them to follow the course of current law.

In this budget we have to ask about all the basic components, about all the basic policies that are involved in a trillion dollars worth of base-line spending and $800 billion worth of base-line revenues and sort of lay out some choices that will close this gap.

### BASIC QUESTIONS ON HOUSECLEANING PROPOSAL

To do that, to undertake a housecleaning rather than an annual housekeeping budget, we asked three basic questions. Are current taxes at 19 percent of GNP too low and, therefore, do we solve the problem on the revenue side in the first instance?

Second, is proposed defense spending, which is about 6.5 percent of GNP now, heading towards 7 percent when the program is fully effective, too high; and, if so, what should be done?

And third, if domestic spending, which now requires about 14 percent of GNP when you include everything from agriculture to the Social Security system, if that is still too high, because we can't close the gap in our budget with existing programs, where do we spend and where do we save as we attempt to restructure the domestic side?

My testimony tries to lay out some answers and reasons for the conclusions that we have come to on each of these three basic questions.

TAX STRUCTURE

The first one, are taxes too low, on page three there is some information that I would like to bring to the attention of the committee in terms of how we answered that question. Number one, from a historic point of view, 19 percent of GNP in taxes is about what we have taken from the American people for the entire 20-year period from 1960 to 1980. During that period, somehow we made ends meet. We had a hot war; we had a cold war; we had a great society; we had a slowdown and backing off from great society programs near the end when we found out they weren't working. But nevertheless, over that period, we found it possible to meet both the national security requirements and domestic welfare requirements of this country on a little over 19 percent of GNP.

So to begin with, I don't think it can be assumed that the current level of tax revenues generated by current law is necessarily too low, at least by historic standards.

REBUILDING OF TAX BASE

Second, I think we need to recognize that ever since August 1981, we have steadily rebuilt the tax base that was probably cut too much in that first big bill. Had we left the tax code as it was after the 1981 Act, we would be taking in 17 percent of GNP in 1986, $80 billion less than we are actually planning.

But obviously, when you are spending 25 percent, you propose to collect only 17 percent, that would lead to practically a banana republic style state of finances. So in the last 3 years we have increased revenues in five different tax bills: the TEFRA bill, the Society Security bill, DEFRA bill last summer, and smaller bills.

I would just point out to the committee in total those five bills that rebuild the tax base increase revenues in 1986 by $80 billion a year alone and by more than $300 billion over the 1986, 1987 and 1988 period which your budget resolution will recover. So that is another dimension of the issue. Clearly now that we are taking in again 19 percent of GNP, that is the place to start.

Third, the tax issue has been raised twice in presidential election campaigns in this decade. Both times the American people said they didn't want taxes much above 19 percent of GNP. In 1982 it was up to 22 percent. The people said no. Then Mondale proposed to take it up to 21 or 22 percent and the public obviously said no.

Finally, the line in the sand that I think has been drawn by the electorate has been put into concrete by the President. He has indicated that there will be no deficit reduction package that includes tax-raising measures. And if we believe that the situation is critical, then as a first resort we have to work on the spending side if we expect a package to be enacted and the situation to change.

DEFENSE SPENDING

The second question we address is, is defense spending too high at the current level that we are proposing for 1986, $313 billion. On page 5 I try to provide some historic perspective on that again. While compared to the very low point of defense spending in 1980, 6.5 percent is up from about 5 percent. But compared to what we have found it necessary to expend over most of the post-war period, it is still an exceedingly modest figure.

During most of the 1950's and 1960's, both pre-Vietnam and during Vietnam, we spent 8 to 9 percent of a much smaller economy on defense. If we implement the plan proposed in the 1986 budget, we will barely get above 7 percent as far out as 1988.

So in terms of an economic burden, relative to what we have experienced in the past, it is difficult to say that it is too high.

Second, we shouldn't spend on the basis of a percent of GNP. We should spend on the basis of what we need to meet the threat, carry on various foreign policies, security objectives, and to provide for accomplishing the missions that we have laid out for the armed forces.

I would point out that in 1980, a bipartisan majority of Congress concluded that all aspects and dimensions of our defense establishment were woefully inadequate, from pay on the one side to the strategic balance and the weapons that were not under development then on the other side, and we launched a multi-year buildup to rectify that.

I point out on page 6 of my testimony that beginning in 1980 and marching forward through 1985's enacted appropriations bill, the administration has requested from the Congress $1.235 trillion in defense appropriations. The Congress has approved $1.174 trillion for those 5 years, 95 percent of the request. That indicates that the basic cost drivers in the defense budget, whether it is rectifying the strategic balance, improving pay, modestly increasing the level of our end strength by about 100,000 or 5 percent, undertaking the various conventional modernization programs we have under way, and providing more adequately for readiness training, spares, ammunition, and so forth, these basic policy drivers have been approved by the Congress and, therefore, the $313 billion request in 1986 is only the annual installment of the multi-year buildup in defense recovery that we have under way.

Congress has made cuts from time to time in the past. I think the important thing is that you have agreed that in order to rectify these defense shortcomings, it was necessary to double the defense budget between 1980 and 1985 from $140 billion to $285 billion, and that 100 percent increase that we agreed on is far more important and far more significant for the amount of defense dollars that are needed than the 5 percent cuts that you have imposed each year, the same 5 percent mostly doing with the price of fuel, mostly doing with the dollar exchange rate, mostly involving pacing of economies, but not disagreeing with the basic cost drivers in terms of our force structure and weapons structure.

I have tried to provide some indication of that in my testimony. Just as one example, I would call your attention to page 9, which addresses

both our strategic and conventional force modernization program, our basic equipment, from strategic missiles to tanks.

Over the 5-year period of attempting to correct this defense problem, we have concluded jointly, as indicated by enacted appropriations bills, that some 33 strategic and conventional systems which were barely in existence or still in the R&D stage in 1980 needed to be launched and built up to full production rates. Those 33 systems that are listed on this page range from the B-1 to Maverick missiles, which cost about $6 billion in appropriations in 1980. The funded level approved in 1985 was $42 billion compared to $6 billion, as these systems have come on line in the production, and we have moved towards the economic procurement rates. And the request for 1986 is $45 billion, another $3 billion basically following the track that we have under way.

INCREASE IN READINESS

The same can be said for our increases in readiness, which are shown on the next page, our increases in end strength and pay, which are shown on page 11, and our increases in conventional RDT&E, which are shown on page 12.

So I think it is fair to come to the conclusion that defense is not too high both in the judgment of the administration and in the 5-year program, the set of policies and cost drivers that the Congress has approved after analyzing for hours and hours 5 years of appropriations requests throughout the defense committees of Congress.

REDUCTIONS IN DOMESTIC SECTOR

That leads us to the domestic sector for most of the reduction to take place. We suggested in this testimony that you think about that massive amount of spending, nearly $600 billion on the domestic side, 14 percent of GNP. There are only really three sectors to consider: the social contract that we have for the elderly and the unemployed; Medicare, Social Security and unemployment. That is $290 billion, or half of the domestic total.

We conclude that there is very little change desired or possible here given the attitude of the American public and the commitments that we have made. We propose to squeeze down fairly hard on Medicare providers and make some other minor changes. But out of that $290 billion total, less than $4 billion in savings are achieved the first year.

SOCIAL SAFETY NET

The second component is worth about $90 billion of the $590 billion total in domestic spending. That is the social safety net, means tested, transfer payments that go to low-income populations. We felt in 1981 that this sector of the budget was totally out of control, that it increased from $10 billion to $90 billion in 18 years, in constant dollars, to say nothing of nominal dollars.

We persuaded the Congress to make extensive changes in the entitlements, the eligibility benefits structure and food stamps, AFDC, many other related programs, and have now concluded that this sector of the

budget is under control. In real terms, it is neither shrinking nor rising. It is steady at $90 billion a year, meeting our basic medical, nutrition, housing, cash assistance needs under a much more tightened structure than we had in 1980.

We propose some very minor changes, particularly with regard to reimbursement, to States for their Medicaid expenditures, but essentially no large changes. About $4 billion is proposed in this sector of the budget.

PUBLIC FUNCTIONS OF GOVERNMENT

So that leaves us with everything else in government, what we might call the public functions of government, that range from health research to harbor dredging. That is $210 billion. And we conclude in order to shrink that 14 percent claim, in order to reduce the total spending levels so we can close this deficit gap, major choices have to be made in this sector of the budget—not simply to freeze things, not simply to reform things, but actually to eliminate dozens of programs and to reform those that we need and that remain in the budget.

THREE CATEGORIES OF PROPOSALS

You are familiar with the whole variety of these proposals. But I will just finish by saying they come under three categories.

No. 1, programs that involve subsidies to local economic development or fiscal transfers to local government: general revenue sharing, UDAG, and so forth. We propose to eliminate those because our financial accounts are simply in too serious a shape to permit that kind of spending relative to the better position of State and local governments.

No. 2, we have proposed where there are large subsidies to particular industries or businesses or commercial activities or special regions of the country, these subsidies need to be eliminated entirely or substantially reformed. That encompasses our proposals for navigation user fees, to eliminate the SBA, the Export-Import Bank, substantially reform and phase out farm price supports, to collect some of the debt that the power market administrations and other related agencies owe us.

Finally, we propose in the case of some large middle-income benefit programs that are desirable and embody commitments we must keep, it is possible to reform them and substantially reduce their budget cost.

This is the reason for the student aid reforms, veterans health care system reforms, the Federal civil service retirement reforms, and so forth.

None of these choices are easy and none of them will be accepted I think obviously in total by any member of this committee. But if we conclude that we are spending basically what we need for defense, we are taking what we can and should from the American people in taxes, we have commitments for the social contract and to the safety net beneficiaries, then this is the area of the budget, even though it may be only 20 percent of the total, where the major surgery has to occur. If someone can think of how to do it differently, those suggestions would be welcome. But it doesn't seem to me if we accept the starting premises, we have many other choices.

Beyond that, many of these programs are not really Federal responsibilities in any philosophical sense. Now is a good time to face that issue.

Thank you, Mr. Chairman.

Chairman HATFIELD. Thank you, Mr. Stockman.

Mr. Niskanen?

## STATEMENT OF WILLIAM NISKANEN

### GENERAL DIMENSIONS OF BUDGET

Mr. NISKANEN. Mr. Chairman, my testimony summarizes the administration's economic forecast and the reasons for it. With your permission, I would like to submit it for the record.

Chairman HATFIELD. It will be received for the record.

Mr. NISKANEN. May I expand on Dave's remarks concerning some general dimensions of the budget.

The current Federal budget is now on an explosive path. What I mean is the problems will get worse if no actions are taken. Spending is increasing faster than our economy through the third year of the strongest recovery in 30 years. The Federal debt is increasing faster than the economy on a current services basis throughout the budget horizon.

Neither of these trends can continue, and the problems will get worse rather than better if no actions are taken. Sooner or later Federal spending must be financed by Federal taxes, including the particularly distortive tax of inflation. And a reduction of Federal spending is necessary to avoid some future tax increase.

President Reagan's budget for fiscal year 1986 is the minimum necessary to put the budget on a sustainable path. More action may be necessary in future years. The President's budget does not eliminate the deficit problem or the debt problem, but given our economic projections, it is enough to at least stabilize the problem so it doesn't get worse rather than better.

We can always address one of these issues, the deficit or the debt issue, without addressing the other, but that would be a mistake. We could, of course, reduce the deficit by an increase in taxes. We can reduce it by a reduction of spending. But only spending restraint is sufficient to put the overall budget on a sustainable path relative to the size of our economy.

### LINE ITEM REVIEW OF BUDGET

We went into the budget this fall in a quite discriminating manner. It was not arbitrary, across the board cuts of programs of widely different value. We went into it literally line item by line item, with probably the most careful presidential review in years, exercising three criteria.

Do the programs have an explicit constitutional basis? Are they programs for which the Federal Government is charged in our fundamental political contract? Second, do the programs serve any important national purpose? In other words, do people in one part of the

Nation benefit from programs that serve sectors or regions elsewhere in the country? Third, have the programs been efficient in meeting their purported goals?

On the basis of that, we have presented a budget, which I am pleased to say Senator Proxmire and others recognize, reflects a lot of thought about what it is that it is important for the Federal Government to do and where the cuts should take place, given our constitutional responsibilities, and where the Federal Government has proved to be efficient relative to where it has not proved to be efficient in the past.

I am encouraged that the Senate and the House are taking this budget seriously. I encourage you to review it with as much or more care than we have in preparing it, because an action of the magnitude we are proposing, I want to repeat, is the minimum necessary to put the Federal budget on a sustainable path.

If economic conditions are not as fortunate as what we expect, more action, of course, would be necessary. More action may be appropriate in any case. There is no magic number about the magnitude of the deficit that is optimal. Lower is better than higher.

Let's get on with the task. Let's treat it like a housecleaning budget and not as a business-as-usual budget.

Chairman HATFIELD. Thank you.

SIMPLIFIED TAX FORM

Mr. Baker, you referred to the President's inaugural address and one other comment in that inaugural address was the urge for Congress to enact a simplified tax form, as I believe he called it an historic reform for fairness and growth.

In your confirmation hearings, you stated, as I recall, that you considered that deficit reduction and tax reform had equal priority. When might we expect the administration's tax reform or tax simplification measure?

Secretary BAKER. Mr. Chairman, let me first say that tax reform or tax simplification does enjoy equal priority with deficit reduction as far as the President is concerned, as he indicated in the State of the Union. We have been reluctant to attach a specific date to when you might see a particular proposal or particular bill because we do not underestimate the magnitude of the task before us.

REFORM OF FEDERAL TAX CODE

To reform the entire Federal tax code is a major undertaking. We are in the process now at the Treasury Department of reviewing the proposal that was put forth on November 27. We expect to begin discussing elements of that proposal soon with the various jurisdictional committee chairmen here on the Hill and with congressional authors of similar plans.

We have not as yet begun that process. We would hope to begin it in the immediate future. I am sorry I am not able to give you a specific date by which a legislative proposal will be presented. The President said in his state of the Union message that he would like to see it done this year. I would simply repeat that.

Chairman HATFIELD. You mean we have a range of February to December?

Secretary BAKER. We are going to get it up here, sir, just as fast as we can, but I am not able to give you a specific date.

SPENDING AND REVENUE SOLUTIONS

Chairman HATFIELD. You know, Mr. Secretary, some of us look upon this problem perhaps in a little different perspective, that there are really two sides to the coin. You have the spending side and you have the revenue side. Mr. Mondale in the campaign stressed the revenue side. President Reagan stressed the spending side. But really I think we are only dealing with half of the solution in both cases.

It seems to me that we in the appropriations process are expected to carry out, as we have for the last 4 years, fiscal constraint of any kind within the budget. This committee, for example, under-appropriated about $800 million of the administration's request in domestic non-defense spending last year. We have been performing that task and we have been out there in the middle of the arena doing that, happily so, because we believe in it.

REVENUE COLLECTIONS

But on the other hand, we are deeply concerned that there be some kind of focus given to what we can expect to do from the revenue side of this problem. For instance, we are told that at the present time we are losing as much as $24 billion from tax shelters. The Commissioner of the IRS tells us we are losing perhaps as much as $90 billion last year in taxes that were not paid.

So my question to you then, if the administration has not yet put its tax revenue program together, and we don't really know when we will get it, what are you doing administratively to collect those revenues, $90 billion as an example, or handle these tax shelter problems of some $24 billion?

Secretary BAKER. Mr. Chairman, the tax shelter problems we would expect to address in connection with a tax simplification or tax reform proposal.

As far as the underground economy and attempting to get the $90 billion or so that escapes taxation is concerned, I think it is fair to say the Internal Revenue Service is doing what they can to seek to redress that situation.

MIXED USE PROPERTY

We have a situation before us today involving the use of automobiles that have a mixed use. The Deficit Reduction Act of 1984 required that the Internal Revenue Service come forth with some rules with respect to trying to collect the revenue on mixed use property, revenue that was escaping taxation.

The Internal Revenue Service has come forward with those rules. As you know and we all know, they are highly unpopular. We have promulgated here just last Friday some amendments which we hope will take care of that problem, establishing some safe harbors.

All I can tell you is that the Service is trying to do what it can in that regard.

Chairman HATFIELD. Do you have any new plans or new programs to deal with that?

Secretary BAKER. Nothing, sir, beyond what will eventually emerge from an overall reform of the tax system.

### TAX EXPENDITURES

Chairman HATFIELD. Mr. Secretary, let me just ask one question on the tax expenditure side. As you know, this is a very significant amount of money, and it has been going up at a very definite rate of increase. In fact, I think it will go up another $40 billion in the current year, reaching about $404 billion.

Now the administration is proposing tuition tax credits, enterprise zones, and other programs that will erode that tax revenue side further by about $400 million, which in light of the $200 billion deficit may not seem like a great deal, but it is still further erosion, far more than offsetting the tinkering with user fees and a few other things Mr. Stockman has come up with.

But would you support a freeze on the tax expenditure side of any new programs that might be enacted until we get some kind of comprehensive tax revenue reform program?

Secretary BAKER. Mr. Chairman, if we get a comprehensive tax reform program this year, in all likelihood you will have a freeze. However, I have to say that in regard to the proposals that the President has submitted in past years and is resubmitting this year, no, I would not support such a freeze, although I would second what you just said about the minimal revenue effect of those proposals. I think taken all together, every revenue proposal that is in our budget adds up to only $1 billion by 1987. In the context of the overall budget amounts, that is not a whole lot of money.

Chairman HATFIELD. Yes. Again, that is not always an easy thing to project out that far. It may be only $400 million this year, but those things escalate.

My time is up. I will defer to the Senator from Mississippi.

## STATEMENT OF SENATOR STENNIS

### ACTION NEEDED TO SOLVE DEFICIT PROBLEMS

Senator STENNIS. Mr. Chairman, I will be brief. I have had more time to read and compare and try to reach conclusions here in the last 2 to 3 months. I am not dealing in personalities. I had already been very much attracted to what Mr. Volcker said. I had the audacity to call him up and ask him to invite me to breakfast--[Laughter]—so I wouldn't take up any of his time he would otherwise use, but I just wanted to get the benefit of his suggestions—that was 2, 3 years ago.

Anyway, quite seriously, I was around when we had the depression. I was within rock-throwing distance when the banks closed in the 1930's, I mean the little banks. I wasn't anywhere around the others.

I was down on the farm when the boll weevils came and ate up the cotton. I remember my father saying the next year we would get along on less, down there in that barren cotton field.

This thing didn't dawn on me so severely at first, but my goodness, when these old deficits come bounding in here, a hundred billion dollars more than expected, something is wrong somewhere and something positive has to be done about it.

INFLUX INTO U.S. OF FOREIGN CAPITAL

Now I have no full answer. I want to mention that the thing that broke the camel's back with me was when it was pointed out that the trend in foreign capital is taking over a larger and larger percentage of our securities—that we go on the market and raise money and that they are buying more and more percentagewise. We were, therefore, approaching being a debtor nation—these are not my words, these are Mr. Volcker's words—that we were approaching a point where we could become and would become a debtor nation. I got into that one in a hurry. I am distressed about this. I am saying the people are, too—don't doubt it now.

Someone asked me the other day, we are in a bad fix, aren't we? I said the people are in a bad fix. We can talk about the current office holders being in a bad fix, but it is the people as a whole who are in a bad fix.

POSITIVE STEPS NEEDED TO REDUCE DEFICITS

I just know something can be done about it. We have always met these crises of one kind or another. The President of the United States is not going to lie down and play dead or anything else. But we can get together on something. It will start in a different direction. That is where I am going to go all the year on these matters, as near as I can. I will go in and reform or combine or whatever you want to call it. I might join one of those. I don't want to leave it out. But something has to be done, ladies and gentlemen. Time may be short. Patience may not be as long as we think it is.

I don't claim to have any knowledge of government but I do have just a little knowledge of human nature. When doubt sets up in the mind, my lord, it travels fast. So I think we better get ready.

I am glad to see you pushing these programs. Push them and see how many votes you get. See what the reactions are. I don't think we are going to capitulate, that things will be over in a few days for us and all. Not on your life.

But we are the only ones who have the power now under the Constitution to move effectively. So I am trying to put together and will round out the reasons that I can give for why we have to take some effective action.

It seems to me, with all deference to everyone, you are starting at this thing just one end of the problem at a time. You are going to do it all by reducing outflow. Others are going to do it all by increasing the income. I don't believe either one can do it. It is too late for that.

So my contribution will not be great; it will be small. But I am going to do what I can along these lines because I am totally convinced, totally convinced, that it is the hand of necessity that is pressing on us. We are the elected officials. We are the ones under the Constitution that have that power, and we can't transfer it to anyone else.

As I say, I commend you for pressing hard, preaching hard, and don't waste any time.

I hope I didn't run over.

Chairman HATFIELD. Thank you very much, Senator.

The Senator from Alaska.

Senator STEVENS. Thank you, Mr. Chairman.

## STATEMENT OF SENATOR STEVENS

### STRENGTH OF DOLLAR ABROAD

Mr. Secretary, it seems to me one of the basic problems we are dealing with on our economy today is the strength of the dollar abroad and what it has done to our exports and how it really has impacted some of the things that the Senator from Mississippi has just talked about, the massive influx of foreign capital, the potential in the future years of exporting substantial amounts in terms of interest and dividends, increasing our imbalance again. What does this budget do about that problem?

Secretary BAKER. Senator, it calls for the reduction of deficit by $50 billion in 1986. It calls for all of us to do what Senator Stennis just suggested, and that is to recognize that these deficits are too big, to question how long we have to deal with them, and to make some of the really politically tough choices that confront us.

If we can reduce this deficit, that should have some beneficial effect. It should tend hopefully to lower real interest rates. We can continue to do what we are doing in the executive branch to encourage our trading partners to adopt some of the same or similar policies we have adopted to strengthen their economies so the dollar won't be as strong in relation to those currencies as it presently is.

But regarding how this budget helps with that, I think what it does is call for an absolute freeze in overall program spending, fiscal 1986 over fiscal 1985. I think that is an ambitious undertaking, and I think it took a certain amount of political courage, quite frankly, for the President to send that up here because it does, as you know, take on a number of his constituencies.

Senator STEVENS. Thank you. I agree with you. I am pleased to see this budget here.

### DANGER IN MULTIPLE BUDGETS

Mr. Stockman, I am a little worried about some of the things that have been coming out. This is the first time I have had an occasion to ask you questions this year. I see now a House Republican budget, a Senate Republican budget, a House majority budget. I don't know if our colleagues in the Senate who represent the minority party are going to have a separate budget or not. We have the President's budget.

Aren't we losing the battle of the budget by virtue of this proliferation of budgets?

Mr. STOCKMAN. Senator, I think that is a danger. On the other hand, it happens every year. I said this is a budget of basic choices, not minor modifications, tampering. This is a big system. There are 535 people that have their oar in the water. So there are a lot of modifications of the different approaches.

If we recognize we don't have unlimited time and allow everybody to make their offering early and lay them out on the table and compare where we stand and where we differ, I think that we can in good time get a package together. But I think everyone who is drawing up their budget plan in this early stage ought to ask those basic questions I did and answer them.

The more of these questions we can get answered, the sooner we can put the detailed, concrete package together. Are taxes too low? I think the answer is no. When we can get Congress to answer that affirmatively and set revenues aside for the duration of this deficit reduction effort, I think we will be halfway towards getting that package. If we can stop this exaggerated, and I think you agree with me, rhetorical differences that we have about defense and say where do we really differ about programs, systems and costs, objectives, I think that issue can meld down to a more manageable size as well. Then that will put us to work in this $600 billion spending side of the budget. That is where we have defined domestic spending. That is where we have to find the answers.

We can work ourselves towards a $50 billion package the first year if we will follow that process.

COMPOUNDING OF INTEREST

Senator STEVENS. We are seeing interest compounding each year, the interest on the national debt compounding. If we achieve the $50 billion, does that mean we will start into the point where we will pay some of the interest on the national debt in 1986?

Mr. STOCKMAN. In 1986, even with a $50 billion reduction, interest costs will go up. But in future years interest costs can be stabilized if interest rates continue to come down. If we do nothing about the structural imbalance between spending and revenues and interest rates stay where they are today, we could be facing well in excess of $200 billion worth of debt service compared to about $130 billion at the present date.

So I think that is a clear indication of what we can gain if we act and what we are threatened with if we fail to act.

Senator STEVENS. You are netting it out, aren't you, in terms of the $135 billion?

Mr. STOCKMAN. Yes.

Senator STEVENS. It actually is above $165 billion in 1986, isn't it?

Mr. STOCKMAN. I think you are talking about total interest on the total debt. If you net out some of the interest the Treasury receives, then the current number for 1985 is about $130 billion. If we do nothing,

the number is $145 billion for 1986. If we implement $50 billion, it would be about $142 billion.

FEDERAL GOVERNMENT RESPONSIBILITY TO WESTERN UNITED STATES

Senator STEVENS. My last question really, Mr. Stockman, goes to another subject entirely, but those of us who come from the West live in an area where the Federal Government owns the vast majority of our lands. As we come to a period of really decontrol, I mean we are going to try to get the Federal Government out of the lives of business and people and union people, out of the economy as much as possible, we are going to end up with a situation where the only place the Federal Government is going to have total control is going to be the West. It is an absentee landlord. It exercises substantial controls of our daily lives. Yet, this budget seems to reduce the landlord's responsibility in the West as compared to government responsibility nationwide. Do you agree with that?

Mr. STOCKMAN. I think we are trying to reduce the management costs of the landlord. I don't think we are trying to reduce the proper functions and responsibilities that the Federal Government carries out. I am not sure what your point is.

Senator STEVENS. You don't take constraints off the West in terms of the controls over Federal lands. Yet you take away the financing for the West that has in fact been the evening of the situation between East and West. When I say West, west of the Mississippi River. Eighteen of the nineteen Western States have substantial Federal lands. As a matter of fact, in my State, for instance, it is well over 60 percent controlled by the Federal Government.

This budget impacts those land agencies that deal with that Federal land on the basis of a landowner as opposed to a government. I would like to know why.

Mr. STOCKMAN. I am trying to identify which particular change you are objecting to. The National Park Service, we are proposing not to buy any more land, but we are proposing to maintain what we have with a pretty good sized budget.

Maybe what you are referring to is the proposal to reform Federal revenue sharing with States and counties on mineral and forest receipts.

Senator STEVENS. That is one of them. The Federal Government's contribution to power in Western States. You mentioned it yourself.

Mr. STOCKMAN. Yes, OK. Under the reform of Federal receipts, mineral and forest receipts sharing, we think there is a good reason. Right now there is gross revenue sharing. Whatever revenues we take in from the sale of timber or the leasing of minerals, the States get either 25 or 50 percent, depending whether it is minerals or timber. If it is Alaska, it gets about 90 percent.

What we are saying is it costs us money to maintain those forest lands, to lease those mineral tracts, to engage in all of the upkeep activities that produces those revenues. We would like to change that to net profit sharing, take off the top of the gross receipts from timber and mineral sales what it costs the BLM and other Federal agencies to produce those receipts and then share the profit 50 percent, as it exists today on minerals, a quarter as it exists today on certain forest receipts, with the States exactly as we do now.

But if it is a joint proposition of your land and our ownership, let's make it net profit sharing rather than gross revenue sharing.

I am not sure that that should be an unacceptable concept. The issue will arise of what do you allocate by way of overhead of BLM costs to the actual production of forest and mineral receipts. We can argue about that. It may be bigger or smaller than we are proposing. But at least we would like to sell you on the concept.

Senator STEVENS. How about a substantial review of the needs of the Federal Government for governance of land in the West and turn the rest over to the private economy?

Mr. STOCKMAN. We have proposed doing some of that from time to time. It was met with a firestorm of opposition, as I remember, from those regions.

Senator STEVENS. Thank you, Mr. Chairman.

Chairman HATFIELD. Senator Inouye?

Senator INOUYE. Thank you, Mr. Chairman.

## STATEMENT OF SENATOR INOUYE

### PROJECTED BUDGET DEFICIT

Mr. Secretary, we are here because of the budget deficit. What is the present picture? What is the projected budget deficit for this fiscal year and the next one?

Secretary BAKER. Senator, the deficit that is projected with the policy changes we are suggesting for fiscal 1986 is $180 billion. The budget deficit that we are projecting for 1987 is $165 billion. For 1988 it is $144 billion. And for 1989 it is $108 billion.

### AVAILABLE FUNDS IN NATIONAL MONEY MARKET

Senator INOUYE. What is the available moneys in the national money market today? How much is available?

Secretary BAKER. I am not sure I understand your question. Are you asking whether we are having trouble financing the total Federal debt?

Senator INOUYE. No. What is available in our Nation in terms of credit?

Secretary BAKER. I can't answer that, Senator.

Senator INOUYE. Mr. Stockman?

Mr. STOCKMAN. Senator, I think credit markets are international and fluid. A better comparison is with the net private savings generated in our private economy. I used that in my opening remarks.

If we do nothing about the deficit in 1986, it will be $230 billion. That will soak up 66 percent of the net private savings flow of our entire economy. So we would only have a third left for everything else we need to do, whether it is build houses or local schools or factories or buy equipment, invest in equipment, and so forth.

That isn't sustainable. It isn't tolerable. That is why, we need to reduce it as much and as fast as we possibly can.

CLARIFICATION ON ADMINISTRATION BUDGET

Senator INOUYE. Following up on the question by my friend from Alaska, when we speak of this budget here, are we speaking of a Stockman budget or a Reagan budget? I am not asking this facetiously, because if you look at headlines, it is the Stockman budget. Is this the Stockman budget?

Mr. STOCKMAN. Well, I would call your attention to the message in the front of the gray document called the 1986 budget. It is not signed by me, so I think it is pretty clear where this budget came from.

As a matter of fact, to reinforce what Bill Niskanen said a while ago, the President actually spent a goodly number of weeks going through the budget line by line, hearing debate and discussion on the programs, the expenditures involved, and making all of these basic decisions about programs we have proposed to eliminate or terminate. He made those decisions. I think this indicates the direction that he believes, as painful as it may sound, in the short run politically we need to go philosophically in order to get our budget back in line with our expenditures.

Senator INOUYE. A bit more specifically, that would mean that your budget treatment on the Farmers Home Administration, Small Business Administration, ExIm Bank, is based upon decisions made by the President of the United States?

Mr. STOCKMAN. Well, yes. In the case of the Small Business Administration, there was a difference within the Cabinet on that. It was well known. It was in the paper. That decision was taken to him and he made a decision. The same is true on the other items that you mentioned.

Senator INOUYE. On the Farmers Home also?

Mr. STOCKMAN. Yes, I won't say that I wasn't responsible for recommending some of these measures. I was.

Secretary BAKER. Senator, may I just chime in and second what Mr. Stockman has said. I was there and those were the President's decisions.

Senator INOUYE. Then when we speak of the farm program, we are speaking of the President's farm program.

I just want this clear, because I receive letters all the time asking me to vote against the Stockman farm program. [Laughter.]

Mr. STOCKMAN. If I can help clarify that—[Laughter]—it is very apparent to me after 4 years that the best way that interest groups can campaign against a change that is justified, necessary, is to blame it on the Office of Management and Budget. That is what a variety of groups do. That is one technique of political argumentation.

But that isn't the truth of the matter. The truth of the matter is this is the President's budget. He has to make some tough choices. The farm program and farm credit recommendations are among those.

CUTS IN EDUCATION AND STUDENT LOANS AND GRANTS

Senator INOUYE. What was the rationale for your cuts in education, the student loans and grants?

Mr. STOCKMAN. Two points. One is for the basic elementary and secondary programs, we have to cut them—disadvantaged, handicapped, bilingual, and so forth—to the level approved by the chairman of the appropriations subcommittee enacted last year.

Higher education, we basically said we are spending $8 billion in grants and GSL interest subsidies. We are reaching nearly one out of every two freshmen. The programs are relatively indiscriminate in terms of the means test we apply. The cuts involve applying the means test so those in the middle and lower end get adequate financial assistances up to $4,000 a year. But someone who comes from a $70,000 per year family, about the same level all of us are, or $75,000, shouldn't get $3,000 worth of GSL interest subsidies over the life of that student loan. They should be eligible for the loan, get the Federal guarantee, but pay the going bank rate, which would be a little higher than the Treasury Bill rate today.

Those are the kinds of changes we are recommending.

Now, a great hue and cry is being stirred up by some that this is a fundamental break with the Federal commitment to higher education. Well, even with our reforms, we will be spending $6 billion to $7 billion a year and we will be providing millions of students grants and loans. We are simply targeting the resources to the lower end where they are needed. Other costs of education have to be met by families, private institutions, State governments, and subsidized heavily. We can't do it all here. A figure of $6 billion or $7 billion a year is a pretty good contribution.

Senator INOUYE. Thank you. Thank you, Mr. Chairman.

Chairman HATFIELD. Thank you, Senator.

Senator Weicker?

STATEMENT OF SENATOR WEICKER

AMENDMENT FOR BALANCED BUDGET

Senator WEICKER. Mr. Secretary, I attended, as you did, the state of the Union. I heard the President call once again for a balanced budget amendment. All of a sudden it occurred to me this isn't the average man on the street. This is the President of the United States. He says we have to balance the budget, and I want a balance the budget amendment.

I sort of analogized in my own mind to the quarterback leaving the team on the field and going up in the stands and saying we want a touchdown. [Laughter.]

Now, my question very simply is why does the President need a constitutional amendment to balance the budget? He is the President of the United States. He told us in 1981, along with Mr. Stockman and members of the administration, the budget would be balanced in 1984. We are now told in the year 1985 it is going to be balanced some years out.

But my main question is can the President balance the budget without a constitutional amendment?

Secretary BAKER. You ask me why he needs a constitutional amendment, Senator. My answer to that would be he needs it, quite frankly, in order to give us in the executive branch and you in the legislative branch the political will to bring about the balanced budget. It is not so much a case that he should not ask for a balanced budget if he is not going to submit one, because it is not a question of balancing it in one year. He has never said he could balance it in one year. True, he argued in 1980 he would have it balanced in 1984 and he has admitted he was unable to perform on that promise.

But it would serve a useful purpose, I think, both for us downtown and for you up here if we had a balanced budget amendment that would enable us to maintain the discipline that is necessary to keep it in balance once we got it there.

MEANS OF ACHIEVING BALANCED BUDGET

Senator WEICKER. Now, Mr. Stockman, let's turn it around. You made the statement, I believe, that we assume we are not going to reduce defense spending, not going to raise revenues, there was a third part—Social Security was what you mentioned—we assume these things. Let's take the assumption the other way around. If we assume we are going to reduce defense spending, we are going to raise taxes, and we are going to reform the entitlements, can we balance the budget?

Mr. STOCKMAN. Well, Senator, there are a lot of ways to get there. I said that anybody who proposes to stabilize this fiscal problem has to sit down and answer some basic questions, which you have just raised.

In my testimony I tried to lay out those questions, and the reasons for the answers that we came up with in the administration are reflected in our budget.

Now, if you believe that 19 percent of GNP as a take in Federal taxes is too low, you can work on the revenue side. If you believe somehow after 5 years, after a 95 percent concensus on the defense budget, we can all of a sudden freeze it in mid air, stop everything we have been doing to repair our defense capacity, then you might put on your piece of paper some defense numbers.

But I am saying we concluded neither of those things could or should be done, and there were a lot of other more desirable things to do on the domestic side.

I know you disagree with that. You disagree about SBA. I guess we are going to talk about that Thursday. That is fine. But I think we have some reasons for that proposal, and that is a choice that we have made.

Senator WEICKER. I don't disagree as a matter of just my philosophy or opinion. The fact is that the dollars are in the very areas which you won't touch. I don't want to get any lectures on political courage when indeed the only courage that is being exhibited in this budget is to come down on the heads of the weakest elements of our society. As far as the dollars are concerned, they are exactly in the areas I have mentioned and everybody knows it: defense spending, revenue raising, and the entitlements.

Let me get back to another point you made, Mr. Stockman, as to what we agreed on last year in the area of responsibility of my appropriations subcommittee.

NIH GRANTS

The Congress passed last fall and the President signed into law a measure providing funds for NIH to establish and maintain 6,500 grants annually. You have since ordered NIH to fund only 5,000 grants. I would like to know why you are contravening the congressional intent. Is this not a violation of the 1985 Labor-HHS Appropriations Act?

Maybe you would like to tell us which areas do not require funding insofar as research is concerned. Is it cancer, heart disease, arthritis, diabetes? Which, in other words, do you consider extraneous?

Mr. STOCKMAN. Senator, all of the areas require funding and we would like to do more, but we can only do as much as we can afford. The reason that proposal is in the budget is for years we have supported 5,000 new research awards each year, and when you add those to those that are continuing awards that are in the pipeline, it is a pretty healthy and substantial across-the-board research effort out of all the institutes.

Now, in light of the fiscal situation we are walking into, and we all hear it today both in the numbers and speeches, it seemed to me this wasn't the right time to suddenly escalate the program level by 1,500 awards. That is nearly a 30 percent increase in the long run funding level.

Senator WEICKER. Did you indicate that to me last year when the budget was devised?

Mr. STOCKMAN. There was a lot going on when the budget was devised last year. That is simply an assumption behind it. It is not spelled out in the appropriations law, as you know. If I would have had the chance, I probably would have argued with you at the time. You had a number, $32.8 billion. You were able to fit that under there. But that is one year. I don't know how we can keep it for you, 6,500 every year. It would be nice. It would be desirable. It would be helpful. But 5,000 is what we have been doing. I am attempting to persuade you and the Congress that under the current fiscal circumstance, that is a pretty good effort.

APPLICATION OF CONDITIONAL CRITERIA

Senator WEICKER. My last question is to Mr. Niskanen. What is this constitutional mandate you keep referring to as driving the figures of the budget presented to us by the Executive? You keep referring to a constitutional criteria being applied. What is this constitutional criteria?

I want to warn you, so you don't get sandbagged. I have heard my colleagues, mainly on my side of the aisle, say that really the only Federal responsibility according to the Constitution is to provide for the common defense. Is this the criteria we are talking about?

Mr. NISKANEN. Senator Weicker, the Constitution, Article 1, Section 8, spells out a very limited range of enumerated Federal functions. For many years we have gone far beyond that range in the name of the general welfare. But I want each of you to ask whether these programs that we are talking about contribute to the general welfare.

How do you defend in Iowa spending as much on mass urban transit in New York? How do you defend in New York City spending as much on farm subsidies in Iowa? How do you defend to taxpayers giving subsidized loans to a small percentage of small businessmen?

Those are the kinds of tests we are applying. Are these clearly enumerated Federal functions? Do they clearly serve the national general welfare? Have they been effective and efficient in performing those rules?

Senator WEICKER. Of course, I don't want to Balkanize the United States. I am certain there are certain needs that have to be met in Mississippi and Iowa and others that have to be met in Connecticut and New York, et cetera.

Now, about the one that Stockman just referred to, the grants for the National Institutes of Health, do you think that is maybe a national need?

Mr. NISKANEN. I think support of research is one of the more important Federal functions. The issue there is the question of the appropriate and efficient magnitude of research in a given area. That does not mean that whether it is an authorized Federal function, whether it is for our common defense or for R&D, we should spend an unlimited amount.

Senator WEICKER. My time is up, Mr. Chairman.

Chairman HATFIELD. Senator Burdick?

## STATEMENT OF SENATOR BURDICK

### BANKRUPTCIES IN RURAL BANKS

Senator BURDICK. Secretary Baker, does the Department of the Treasury or any of its related agencies to your knowledge have a contingency plan for preventing or isolating a wave of bankruptcies in rural banks if it occurs?

Secretary BAKER. Senator, we are working right now on the farm credit problem. As a matter of fact, I will be going from this hearing to a meeting on that problem.

We are continuing to assess the problem and we consider it serious. We are not treating it lightly. I can't tell you what the answer to the problem is as we sit here, but we are working on the matter, actively.

Senator BURDICK. Does the administration have any plans for an appropriation of Congress in this area?

Secretary BAKER. We have no plans that have been developed at the

moment, Senator, other than the plan which Mr. Stockman announced here last week to broaden the program that was announced last September from a principal reduction program to an interest reduction program.

But as I understood your question, you were asking about the farm credit system of banks as opposed to outright relief for farmers. All I can tell you, sir, is it is a matter we view seriously and we are working on it.

RECOMMENDATIONS TO FEDERAL RESERVE BOARD ON MONETARY POLICY

Senator BURDICK. In the administration's recommendations to the Federal Reserve Board on monetary policy, what is the first priority that the administration would most like to achieve?

Secretary BAKER. What we would like to see is sustained economic growth without inflation.

ACROSS-THE-BOARD FREEZE PROPOSAL

Senator BURDICK. My last question is on the statement you just made to one of my colleagues. You would be in favor of an absolute freeze; is that correct?

Secretary BAKER. An absolute freeze on what, sir?

Senator BURDICK. On everything, on the budget.

Secretary BAKER. No, sir. What I said was an overall freeze in the aggregate on overall program spending, not an absolute freeze across the board, but freezing aggregate program spending at the same level it was in fiscal 1985.

Senator BURDICK. You know you would get some support on a freeze across the board.

Secretary BAKER. Yes, sir. We wouldn't get support that we would need downtown on some aspects. [Laughter] Quite frankly, sir—and Mr. Stockman is better equipped to answer this than I am—an overall freeze across the board does not get you where you need to go. You don't get the deficit reduction of the magnitude that you need.

Senator BURDICK. I have a question for Mr. Stockman also.

EFFECT OF FARM BILL PROPOSAL ON FARM ECONOMY

As you know, Mr. Stockman, my State is a farming State. We rely mostly on cereal grains, sugar beets, potatoes and cattle. Our communities are small rural communities that have a heavy dependence on the farm economy.

I look at the impact this budget will have on the soil conservation efforts, on our quality of life in rural America. When I see the administration farm bill proposals and contrast that with the economic situation out there, I worry that we may understand the price of farm agriculture but not the value of it.

We have about 36,000 farms in North Dakota. Unless the Federal Government steps in with a program to help the farm economy, we will lose at least 4,700 farmers this year. More than half of our farmers believe they have less than 5 years to farm at the current rate of loss.

SAFETY NET FOR AGRICULTURE

Mr. Stockman, there is trouble in the heartland of this country. What I would like to get a sense of today is what is the administration's concept of a safety net for agriculture?

Mr. STOCKMAN. Senator, it is clear to me that you can count everything that is in the budget that attempts to aid agriculture and it is a lot of money, and you agree, but it is not clear to me that many of those efforts aren't part of the problem rather than part of the help.

I have heard more people, regardless of their philosophy about farm programs, saying that the current farm program in place today is a disaster. It cost $60 billion over the last 5 years. Incomes are lower. Prices are lower. We are less competitive. There is more distress in the farm sector than ever before. The credit structure is under severe stress. So we have to conclude that the existing programs aren't working. That is where we started as we attempted to make recommendations to Congress on the price support program, the agriculture credit programs, and lesser programs.

Now, you may have alternatives, but at least we are attempting to cure the underlying cause rather than simply build more on top of the structure that has actually been harmful to the agricultural sector over the last 4 years. We don't think it is reasonable to believe, for instance, that a price support that is so high that it prices us out of the world market contributes to the health of wheat farmers in North Dakota or anywhere else. The same is true with the other commodities.

We think those have to be lowered. We can argue about how much, how fast, but clearly that is one change that needs to be made.

On the other hand, you asked about the safety net. We are not proposing to take the price supports away and let the market fall to a dollar or 50 cents. We would maintain price supports to maintain a minimum floor on the market. That is a safety net.

We don't think you ought to make $2 billion a year of direct subsidized agriculture credit loans to people that are basically not creditworthy. But we do think some credit assistance is needed.

So we have proposed instead a $3 billion guarantee program, but with 25 percent of the risk on the banks and only 75 percent on the Federal Government, to ensure that the credit goes to producers who have sustainable operations over time.

Now, I admit that none of these changes are going to be popular or easy. But if you agree that the current programs aren't working, I hope you would look at the reasons for some of these recommendations that we have made.

ACCEPTABLE SUPPORT LEVELS

Senator BURDICK. You just said that you did not want to do away with the support program. What would be your idea of a level of support that would be a fair safety net?

Mr. STOCKMAN. We have recommended in the farm program, and I am not sure whether you have been briefed or not, a price support level in the first year of 75 percent of the market average for the last 3 years, coupled with income protection of up to about 75 cents a bushel

at maximum in deficiency payments, target price protection, for smaller and medium sized producers, up to a $20,000 limit. Between the market support at 75 percent of the last 3 years and the income subsidy up to $20,000, it seems to me that in this initial transition period that isn't an ungenerous level of safety net support.

But if we just make it open-ended, we are going to spend billions that we can't afford. We won't cure the problem and the deficit will get worse.

Senator BURDICK. Translated into dollars, that safety net would reduce it to about $2.40 for wheat in our area?

Mr. STOCKMAN. No, I don't think so. The current wheat price support is $3.30. Seventy-five percent is about $2.60. So that is about a 70-cent reduction in the loan level.

The target price we are proposing to reduce about a dollar. But still the 75-cent differential between loan and target would be maintained.

Senator BURDICK. It would be someplace between $2.60 and $2.70?

Mr. STOCKMAN. Yes.

Senator BURDICK. Do you think the farmers can survive on that?

Mr. STOCKMAN. Well, I don't think in the long run that will be the market price. I think it will be higher. But we have such a glut of overproduction right now because with the high price supports a lot of new areas came into wheat production undermining the traditional wheat production areas like yours. If we keep those price supports high, we keep making open-ended deficiency payments, you are not going to get some of these people that came into wheat out of the business and into something else. If you don't do that, you are going to have glutted markets, huge carryover markets, and prices down on the floor at whatever price support we agree on politically.

But you would agree that even $3.30, the current price support, over the long run is not necessarily a profitable level. But we have to get this supply and demand balance straightened out.

Senator BURDICK. Just for the record, Mr. Stockman, I want you to know the record shows I voted against bringing in those fragile lands. I think it was a big mistake. We have to find a way around that. You know what the agriculture means to this country. It is estimated that 23 percent of the Gross National Product is directly or indirectly affected by agriculture. So it isn't a few million people we have out there. It is in fact a real strong industry, the strongest in the world. We want to do our best to keep it.

CROP LOANS

Now I get down to one of the specifics. What about the crop loan situation?

Mr. STOCKMAN. Pardon?

Senator BURDICK. What about the loan situation, either authority or guaranteed? How much would be available?

Mr. STOCKMAN. We are proposing $3 billion——

Chairman HATFIELD. Could you be brief on that? Your time is up, Senator.

Mr. STOCKMAN. ——$3 billion in guaranteed operating loans a year to replace the existing $2 billion direct loan program.

Senator BURDICK. Yes, but you hitch it up to a condition that matches after you do something.

Mr. STOCKMAN. They have to take 25 percent of the risk.

Senator BURDICK. Do you think they will?

Mr. STOCKMAN. They ought to.

Senator BURDICK. Well, I hope so. But it is not a straight $3 billion loan guarantee.

Mr. STOCKMAN. No, sir. It is $3 billion worth of loan guarantees provided the banks are willing to take 25 percent of the risk and the taxpayer takes 75. It is a fairly good split of the cost.

Senator BURDICK. If the banker doesn't take 25 percent.

Mr. STOCKMAN. Then the banks and the local communities are letting down their own customers and their own financial base, and I can't imagine they would want to do that.

Chairman HATFIELD. Thank you, Senator.

Senator Cochran?

## STATEMENT OF SENATOR COCHRAN

### RECORDKEEPING ON MILEAGE LOGS FOR VEHICLES

Senator COCHRAN. Thank you very much, Mr. Chairman.

I want to thank you, Secretary Baker, for the prompt reaction to the concern around the country on the recordkeeping requirement of mileage logs for business vehicles and farm vehicles. That continues to be a problem.

I just came back from my State at noon today, having spent a few days visiting with as many people as I could. If I heard any complaints about the government, that was the most prevalent. I will tell you, they really are concerned about the recordkeeping requirements. They are not sure that the reforms that are contained in the new regulations are going to meet all the existing problems. So I hope there will be somebody monitoring these new regulations to see if they are entirely sufficient.

Secretary BAKER. We will be, Senator. We hope that we have taken care of most of the problems. As you know, we have established some safe harbors in most of the areas that seem to me at least to be quite reasonable. We are available on call.

I will have to say for the record that it was the Deficit Reduction Act of 1984 that required the keeping of contemporaneous records. We are doing the best we can with that requirement.

### FUNDING FOR RURAL DEVELOPMENT ACT

Senator COCHRAN. When we were discussing the general welfare and the impact of this budget on the general welfare, I couldn't help but remember that when I was trying to develop a platform to run for Congress in 1972, it occurred to me that one of the best things that could be done was to secure the full funding for the Rural Develop-

ment Act that had just been passed by the Congress. Now, we are coming from that point 12 years ago to a proposal in this budget that almost undoes completely several of the provisions of the Rural Development Act. That Act had a very good reason for being, in my judgment. The reasons are still good reasons.

I think there is a societal need for all the people in the United States not being concentrated in the larger cities or in the suburbs adjacent to all of our cities. There ought to be a minimum standard of life quality in rural America that is attractive enough, so that we have a substantial number of people who will choose to live in the rural areas.

I am afraid if we look at the budget carefully, we see that a lot of the emphasis has been placed on cutting or reducing the commitment of the Federal Government to sustain any kind of minimum quality in rural America.

I worry about that. I may end up voting for some of these reductions, but I worry right now about whether or not, taken as a whole, they are too rough on the rural poor. The budget proposes eliminating completely Farmers Home rural housing programs, and eliminating completely the business and industrial loan program of the Farmers Home Administration that was designed to support the location of businesses in small communities and rural areas, and to provide needed jobs.

We are also seeing the first step toward a complete abolition of the REA programs that provide electric power and access to telephone service to rural poor people who can't otherwise afford them. If they had to pay the actual cost of building generating plants and stretching that out to the rural areas, they couldn't afford it. They couldn't afford to live there and to enjoy any kind of minimum standard of life.

I wonder whether or not there has been an economic analysis of that. Has the Council of Economic Advisers looked at these proposals as a whole to determine whether or not the impact is going to be so severe in rural areas that people are going to leave the rural areas and move back into our cities and cause more problems, both economic and social, for our country?

INCREASE IN RURAL POPULATION

Mr. NISKANEN. Senator Cochran, since the 1970 Census, for the first time in a century, total population in our rural counties has been going up. That has been in many cases because they prefer it. It is a better place to live for many people.

That should not in any way be discouraged. I think the larger question is whether the Federal taxpayers should finance regions bidding against each other for development.

It is very difficult to figure out how that serves any national purpose if we get Mississippi bidding against somebody else with Federal money for location in particular areas.

REA BUDGET

The REA budget, as you know, almost all of it for the last 20 years, has gone into generating power and not into the parts of the transmission and distribution system that are especially costly to rural people. It has almost all been spent on generation.

REA has no special advantage in providing generating electric power. The transmission and distribution network is in place. Almost everybody in this country and almost everybody in rural areas has access to central station power and to a telephone line. That system is in place.

The issue from now on is whether it is valuable to have subsidized Federal credit available to have the REAs buying nuclear reactors in order to generate power. I think that there is a very important question there and we welcome a discussion on it.

We have not done an overall comprehensive economic analysis of the implications of this budget, but in almost every case the recommendations that we have made reflect an accumulation of understanding of how these programs work and research on effects that have taken place over a number of years.

Dave Stockman has had these ideas in his back pocket for a long period of time. It wasn't by accident. We didn't dream up these proposals the last minute.

Senator COCHRAN. Thank you, Mr. Chairman.

Chairman HATFIELD. Thank you, Senator.

Senator Proxmire?

## STATEMENT OF SENATOR PROXMIRE

USE OF PRESIDENTIAL VETO

Senator PROXMIRE. Thank you, Mr. Chairman.

I apologize for having left. I will be as brief as I can.

I am not going to ask you a question, Mr. Stockman. I would just like to suggest you follow through, as I am sure you will, by urging the President to use his veto freely and emphatically. If he gets support from one of either the House or Senate, as you know, that will do the trick.

Furthermore, I think we may surprise a lot of people. There are a lot of misgivings about our ability to substantially reduce the deficit. I think we can if the President will use his veto and if we cut military spending, which I can assure you we will, slash foreign aid, and maybe even shave the space program. I think there are some real possibilities there.

LARGE CORPORATION PROFITS

Now, Mr. Baker, I would like to ask you about the possibility of doing something about the appalling fact that we have some very, very large corporations in the country enjoying big net profits and paying literally nothing in income taxes. We have a minimum tax, but it is a joke. It is very, very ineffective.

We have a situation in which the biggest defense contractor in this country has enjoyed profits of about $1.6 billion since 1972 and paid

nothing in any year in income taxes. That company has credits that will probably permit it to evade any income taxes until the year 2000.

General Electric had profits over 3 years of about $6.7 billion and paid nothing in income taxes.

We could raise a substantial amount by simply having a minimum tax of 15 percent, with no exceptions whatsoever, on corporations that make, say, over a million dollars. Why can't we do that?

Secretary BAKER. Senator, I am not prepared to endorse a minimum tax on corporations, but the point you make is one of the most persuasive arguments there is for an overall reform of the tax system. It is one of the reasons that tax simplification, and tax reform, are one of the President's domestic priorities this year. It is that kind of, quite frankly, vice that we will be seeking to eliminate in reforming the tax system. It may be that there are better ways to get there than a minimum tax.

MINIMUM TAX PROPOSAL

Senator PROXMIRE. I appreciate that answer. I agree with and I support enthusiastically the President's tax reform initiative. I think tax reform is going to be much tougher to get through than a minimum tax. If he can't get tax reform through, a minimum tax may be a fallback. I am talking, of course, about a tax to reduce the deficit. The President's proposal is, understandably, deficit neutral.

Secretary BAKER. Yes, sir.

Senator PROXMIRE. I am talking about the possibility of raising some revenue and thus attacking the deficit through tax code changes.

Mr. Niskanen, what bothers me a great deal about our ability to do something about deficits is our staying power. We had a marvelous economic year in 1984, the best since 1951, from the standpoint of growth, with remarkably low inflation under the circumstances. Nominal interest rates, at least, were down. Nineteen eighty-four was a great year. However in the years 1981 through 1984 deficits were $109 billion, $195 billion and $175 billion respectively. We might have another good year, probably because we will have a deficit of $222 billion or more in 1985.

What concerns me is whether we are going to have the staying power, and I would like to know whether you think we are going to need it, in the event we begin to cut the deficit.

Suppose we cut the deficit to $75 billion. Won't that have the effect of slowing the economy, perhaps increasing unemployment, and possibly taking the heart out of the determination of Congress and the President to stay the course?

Mr. NISKANEN. Senator Proxmire, my reading of the evidence is that the deficit has little or no effect on total demand in the economy and that it would be a mistake to be concerned about the effect of reducing the deficit on reducing total demand.

EFFECT OF DEFICIT ON TOTAL DEMAND

Senator PROXMIRE. You mean that when we run a deficit of 6 percent of the Gross National Product, it doesn't have any effect on total demand? How about the experience we had in World War II when we

went for the first time from 17 percent unemployment to 2 percent unemployment and the deficits were much bigger than 25 percent in relationship to the GNP? Don't you think those deficits had some effect?

Mr. NISKANEN. The evidence suggests that the large increase in government purchases of goods and services during wars has increased total output, but it was the increase in total defense spending and not the deficit that created that effect.

Now I think that we should put aside a worry that reducing the deficit is somehow going to bring this recovery to an end. The economic consequences of reducing the deficit, however, will differ quite a bit depending upon how it is reduced.

If we reduce spending in one way, if we reduce defense, if we reduce transfers and so forth, it will have different effects than if we increase taxes. But the deficit itself is not what is sustaining this recovery. There are two indicators of that.

If the deficit were what were supporting total demand, we should expect two conditions in our economy. One is that money velocity would be unusually high. In fact, it has been unusually low in this recovery.

Second, we should expect consumption to be relatively high compared to investment. In fact, investment is at an all-time high in this recovery.

This is not a deficit-fueled recovery. There is no reason to be concerned that reducing the deficit by itself is going to end the recovery. There is a great reason to be concerned, however, about how the deficit is reduced and that the economic effects will be very different depending upon whether the deficit is reduced by a spending restraint, as the President has proposed, or by tax increases.

Senator PROXMIRE. My time is up, Mr. Chairman. Just let the record show I flatly disagree with my good friend, Mr. Niskanen. I don't think he could be any more wrong. I think the deficit has a lot to do with the recovery, always has and will in the future.

FUNDS RAISED BY MINIMUM CORPORATE TAX

Chairman HATFIELD. Do you know what a 15 percent minimum corporate tax would raise in terms of dollars, you or Secretary Baker, just out of curiosity? Could you furnish that for the record?

Secretary BAKER. Sure.

[The information follows:]

ALTERNATIVE MINIMUM TAX ON CORPORATIONS

A 15 percent alternative minimum tax on corporations would raise revenues by about $3 to $4 billion annually, depending on its specifications.

LEGALITY OF NO INCOME TAX PAYMENTS BY DEFENSE CONTRACTORS

Chairman HATFIELD. I would also like to comment that Senator Proxmire raises this matter of defense contractors and others who have escaped paying any income tax, which was, of course, done quite legally.

Senator PROXMIRE. Pardon me?

Chairman HATFIELD. Which was done legally.

Senator PROXMIRE. By all means. I should have said that. It is our fault, not theirs. They did the right thing from their viewpoint.

Chairman HATFIELD. I don't approve of it, but it is by our own action, either failing to repeal it or correcting it. So the defense contractor can use a 30-year period if he is on a contract.

The Senator from Idaho.

## STATEMENT OF SENATOR MCCLURE

### FINANCIAL DIFFICULTY OF FARMING COMMUNITY

Senator MCCLURE. Thank you very much, Mr. Chairman.

There are three things that have been touched on here that I would like to go back to because I think they are fundamental. I am not sure in which order they should be brought up because I am not sure which is more important right now.

I just returned from a visit to Idaho. I had six different meetings across the State with farmers who are in financial difficulty. I am trying to determine what could be done, and indeed, there is widespread agreement that the programs that created this mess aren't going to cure it. So they are looking for new answers. So am I. I commend you for undertaking that effort.

But one thing that bothers me with the suggestions that have been made is that somehow if we drop target prices, price supports, the price will drop in the marketplace and that will cause reductions in production. Isn't it true that a large part of the increased production worldwide in commodities that have worldwide markets have not been within the United States but have been somewhere else?

Mr. STOCKMAN. Senator, that is true. One argument is that our high price supports have created a world pricing umbrella that makes high cost production less expensive for governments like France, et cetera.

Senator MCCLURE. Isn't it true that a lot of that production lies in countries that are not going to drop that production automatically if price goes down, just as Chile did not drop production of copper just because price went down?

Mr. STOCKMAN. Yes. But on the other hand, their subsidy costs will go up and at some point it will be unnecessary.

Senator MCCLURE. You are gambling we will break those governments before we break our farmers?

Mr. STOCKMAN. The relative effect of a 70-cent reduction in the world wheat price relative to the budget of Argentina is quite substantial.

Senator MCCLURE. Again, I assume the answer didn't contravene what I said. We think we can break the will or the capacity of those governments faster than we break the farmers in this country.

I am not sure of that, frankly. That is one of the questions I hope we will address.

### REVENUE LEVELS

The second question deals with what may be just a difference in the way in which you made the statements. Mr. Secretary, you said that we

ought to reduce the proportion of GNP which we spend to about 21 percent of GNP by the end of this decade. Mr. Stockman was indicating that 19 percent was the traditional level. Does that imply you want to raise revenues by 2 percent?

Secretary BAKER. I think what he was suggesting was that roughly 19 percent is the traditional level of revenues.

Senator MCCLURE. And you say reducing spending to 21 percent is fine. Does that imply either that you are going to have a continued deficit or raise revenues?

Secretary BAKER. Under that scenario, Senator, you would then have a deficit that would be perfectly tolerable in our view, which would be less than 2 percent of GNP.

Senator MCCLURE. So you are really looking at a sustained level of deficit over all time to come.

Secretary BAKER. What I was speaking to, of course, was the track out to fiscal 1989.

Senator MCCLURE. I just wondered where we are going, that is all.

Secretary BAKER. If we can get to that point, we think we would find it a pretty happy circumstance.

Senator MCCLURE. It is a lot happier than now, but I don't think it is very happy. I don't subscribe to that notion, spending yourself red on the installment plan.

Secretary BAKER. I am not suggesting that. A deficit equivalent to 2 percent of GNP is far better.

Senator MCCLURE. But is that our aim? I think many of us up here believe the aim ought to be a balanced budget.

Secretary BAKER. The President has said the balanced budget remains a goal. But he is not projecting that it will be attained in any particular year, as he did in 1980 and was unable to make it.

BUDGET RESOLUTIONS LIE WITH CONGRESS

Senator MCCLURE. I certainly applaud all of the witnesses who have indicated we ought not tolerate these budget deficits. We ought to have a balanced budget. I would like to say to my friend from Connecticut who raised the question about why we need a balanced budget amendment that the problem doesn't lie with the executive branch or downtown, the problem lies up here in the Congress. There has never been a penny spent by the President that wasn't first appropriated by Congress. There hasn't been a single program under which checks are mailed out to entitlements recipients that isn't pursuant to a law that was passed by Congress. The balanced budget amendment is really focused at us and not at you. And perhaps Senator Weicker, along with all the rest of us, needs to look in the mirror.

WORLD TRADE IN CURRENCIES

Finally, Mr. Secretary, the first question that was asked is the first question I had on my list and the first question that the people to my right had on their list, and that was what can we do to correct the imbalance of currencies traded in the world. The strength of the dollar,

which we kind of like, it does something for our self-image, but it is killing us in terms of foreign trade.

I don't see anything that is being done in this budget except the rather generalized thing which you made response to, getting the deficit down is somehow going to help that. Isn't there something much more affirmative we need to do, whether it is wheat exports or automobile imports?

Secretary BAKER. Senator, beyond reducing the deficit and beyond encouraging our trading partners to adopt the kind of policies that have led to the sustained economic growth we enjoy, we don't think there is anything that can or should be done.

You know, we can talk about intervention if you want and a lot of our trading partners like the idea of intervention in the currency exchange markets. We have done that. But its effectiveness is subject to question. So I think our answer to you would be as far as the executive branch is concerned, we need to tackle our fiscal deficit problem. We need to make the tough political choices that that entails, and we need, quite frankly, to encourage our trading partners to do the same thing in their countries that we have done here.

ACTIONS TAKEN ON AUTOMOBILES AND HOUSING

Senator MCCLURE. Mr. Chairman, I know my time is up, but Mr. Secretary, and to the rest of the administration, I hope they will listen, I don't think that really is going to do the kind of job that is necessary to keep our economy on a growth path. If you will look, what happened in the auto industry? It wasn't so much that Lee Iacocca is such a great manager, even though he writes books and gets credit for it. We imposed a quota on imports. That quota on imports was responded to by the Japanese raising the price of their automobiles, which allowed us to compete under the umbrella. That wasn't because we didn't do anything about foreign trade. It was because we did and they benefited.

If you look at the housing industry, the housing industry went down on the burden of high interest rates. We went from about 1.8 million housing starts to less than a million. The timber industry was decimated, as was the housing industry. Last year, because the interest rates are down, housing starts went up to 1.7 million housing starts, which is a very substantial housing program. The timber industry in this country recovered almost not at all because imports from Canada primarily filled that increased demand for lumber and Canadian workers and the Canadian economy benefited for a couple of reasons.

It simply isn't helping us. If you look at the loss of trade in wheat that is piling up in these surpluses, that is destroying this country, it is a 30 or 40 or 50 percent differential in currency, that makes it possible for Argentina to bring wheat to our shores at less than our own producers can do it, even with price supports.

We will have major segments of our economy completely destroyed before we get that corrected if all we say is somehow if we get our own spending house in order everything else will come about.

TRADE DEFICIT PROBLEM

Secretary BAKER. Sir, I understood your question as what can we do about the high dollar. I suppose I should add there are maybe a couple of other things we can do in order to address the trade deficit problem. I have enumerated the two things I think we can do with respect to the dollar.

With respect to the trade problem, and you may not consider it enough, obviously we can do some pretty serious jawboning with our trading partners, as we are currently doing with Japan right now. We have a new initiative and a new round of trade discussions going with them with respect to four product sectors. We can talk to them, for instance, about encouraging the yen to become an international currency so it can compete with the dollar and remove some of the restrictions they have on the yen as far as capital markets are concerned.

We have done that. We will continue to do that.

So in answering your question initially, I was answering what I understood your question to be with respect to the high dollar.

Chairman HATFIELD. I would urge you to keep that negotiation in the nondefense, non-State Department areas of our Federal Government, too. They traded off our mineral industry years ago for South American political treaties and military bases.

Senator Leahy?

Senator LEAHY. Thank you, Mr. Chairman.

STATEMENT OF SENATOR LEAHY

COLD TURKEY APPROACH TO BALANCING BUDGET

One of the witnesses this afternoon said they were glad to see the Senate taking the budget seriously. I think if you have listened to us on both sides of the aisle, you realize that is so.

I hope, though, that you are all taking it seriously, just not looking for slogans to get us out of this. Let me tell you why I say that.

I have been in Vermont the last 10 days and Vermont has to be, I think, generally considered a pretty conservative, cautious State. I could not help but think after discussing this budget all over the State of Vermont, I suddenly thought of my own family. I have three children, two in college and one in high school. With the deficits that are being presented in this budget, or preceding it and the ones that will come after, my children are kind of put in a position where they are going to be paying off these deficits all their lives. It looks to me sort of like they are being told they can make the mortgage payments, but they don't get the house. That is really what it is. We say OK, kids, as soon as you graduate, God bless you, you are out now as good, bona fide taxpayers, and we are going to give you a mortgage to pay off. No housing, nothing to go along with it, but you have a mortgage.

Now, has there been anything in the Constitution or our laws that has stopped the President during the past 5 years from submitting a balanced budget?

Secretary BAKER. No, sir, there is nothing that would have prevented him from submitting a balanced budget. But as I indicated in an earlier answer, I hope, that would be a rather dramatic and painful approach to take, to try and do it cold turkey.

The advantage of a balanced budget amendment is it will provide both us and you with the discipline necessary to maintain that balance once we get there. And you don't get there overnight. You get there by phasing in.

HYPOTHETICAL RESULT OF CONSTITUTIONALLY-MANDATED BUDGET

Senator LEAHY. Let me ask you this: Suppose the first year of the President's administration that a constitutional balanced budget amendment had been passed. What would we have seen differently in the budgets that the President would have submitted during the past 4 years?

Secretary BAKER. That is quite hypothetical, but I suppose that amendment would have called for some period of transition, and you would have seen the President submit a balanced budget upon the end of the transition period since it would have been constitutionally mandated.

Senator LEAHY. But the President and administration have not lost a major spending or tax vote in the past 4 years. In fact,I recall one time when our budget was over by I think about half a percent, half of 1 percent, beyond what the President wanted, and it closed down the Government for a couple of days. One of the phone recorders at the White House telephone number made great dramatic press. At least they were kind enough not to put in the Muzak ones that put you on hold. We spent millions of dollars on the most elaborate of all photo opportunities. And yet that was because we were off by I think it was a half percent. I will grant you double that. Say it was off by 1 percent of the President's proposal.

Now the administration has not lost a major budget battle or tax battle. Why with that kind of a track record in five budgets has not the administration submitted over a 5-year period a balanced budget? Instead we have had spending increase by 50 percent from its 1981 level and the Federal debt more than doubled since 1980 and is about to double again.

Secretary BAKER. My only answer to that, Senator, would be because we haven't had a balanced budget amendment requiring it. You know, you say we haven't lost a major budget or tax battle. I would suggest, and maybe Dave is better equipped to speak to this, but I can recall back in 1981 where we did not get something in the neighborhood of $40 billion in spending cuts that were asked for, which, if you translated them out through the years, would have resulted——

Senator LEAHY. Why didn't the President just veto it?

Secretary BAKER. Well, he got a reasonable percentage of what he asked for.

Senator LEAHY. He was off a half percent and he vetoed it.

Mr. STOCKMAN. Senator, if I could respond, I constantly hear that is about 11 percent of the budget and that is not a major source of the

funding, and for the moment I will agree, that is an appropriation thing.

You have basically eloquently stated the standard orthodoxy about balanced budgets and their budgets. The problem was for 15 years when you could do something about it, you didn't believe it. Now we can't live with it. As a result, we have a short-term problem that took 15 to 20 years to make, and we will stop reciting that orthodoxy if you will avoid the 11th hour conversion.

Senator LEAHY. That is a bit of baloney, quite frankly. You talked about freezing and balanced budgets and so on. We have had two big freeze votes in the Senate. I think the first time, with opposition from the administration, it got 17 votes. The second time it got twice that number.

Secretary Baker has talked about a freeze. I realize you don't mean across the board. You mean overall programs. But I think what you are talking about in the President's budget is not a fair freeze budget. It is a shifting of funding within the spending cap.

AREAS OF BUDGET CUTS

Let's face it. Why? So the Pentagon can continue to get its increase while domestic spending is cut. Let me finish this one thought. All the contemplated cuts or elimination of programs are in agriculture credit, child nutrition, civil service retirement, farm subsidies, public housing, rural housing, rural electric, student aid, veterans medical care, Amtrak, Job Corps, rural development, job sharing, Small Business Administration, economic development, mass transit. If you take them all together, they will only recoup two-thirds of the $30 billion increase the budget would give the Pentagon.

Why not have an across-the-board freeze on every single program? I will vote for it tomorrow, or today if you can bring it up.

Chairman HATFIELD. That is your latest deal.

Mr. STOCKMAN. It is a safe bet.

Secretary BAKER. May I add one thing, Mr. Chairman? You said initially you hoped this budget wasn't just slogans. I would like to tell you that as far as our portion of it at the Treasury Department is concerned, it is not just slogans. That is the reason I inserted the provision in my prepared statement today about revenue sharing, because revenue sharing is a popular program. There is going to be a lot of sentiment for keeping it. But this isn't just slogans. The President has sent this budget up. It does contain some tough political choices. He is prepared to support those.

Senator LEAHY. Thank you.

Chairman HATFIELD. The Senator from Georgia.

Senator MATTINGLY. Thank you, Mr. Chairman.

STATEMENT OF SENATOR MATTINGLY

CONSTITUTIONAL AMENDMENT ON BALANCED BUDGET

I just want to say after listening to Senator Weicker and Senator McClure and Mr. Stockman talk about the balanced budget constitutional amendment, obviously if it did pass it would take some time to implement it. That is one reason that led to an endorsement of the line item veto by the administration.

I believe it would be valuable to try the proposal at least for a 2-year test period. Do you believe that it would enable the President to exercise his veto without bringing the Government to a halt? I would like your comment on that.

Mr. STOCKMAN. Senator, we obviously have strongly supported the line item veto concept. You have proposed a legislative way of testing it. I think that is a good idea. Some fear that it would fundamentally disrupt the balance of power in the branches. This would be a way to find out on a short-term basis in a tough fiscal environment. So we think it is a good idea.

Chairman HATFIELD. Have you ever tried poison oak on a short-term basis? [Laughter]

Mr. STOCKMAN. You have various antidotes, Mr. Chairman. You can live with it.

BUDGET FREEZE PROPOSAL

Senator MATTINGLY. Going back to the freeze, I know there is a lot of concern over what kind of freeze. Eventually, no matter what resolution comes out of the Budget Committee, it is going to come to the floor of the Senate and it is going to be attacked one way or the other.

What is wrong with excluding interest on the debt and Social Security; with supporting a freeze on the budget, even though it doesn't get us to the point we want to be, in order to get it out of the Budget Committee and to the floor of the Senate where it can be amended as the Senate sees fit?

Mr. STOCKMAN. My response simply would be my opening comment. This is a budget of choices. As appealing as it may sound, we are abdicating our responsibility if we chop every number off at the same level as last year. It assumes every dollar is created equal, that all Federal spending has the same priority, that everything merits the same fiscal treatment.

We can't operate that way. It is not true on defense. It is not true on some domestic things. I think we are just misleading ourselves if we say we will delegate this to some robots who will give the budget a haircut. It is a much bigger job than that.

REFORMS ON BUDGET ACTIVITY

Senator MATTINGLY. But it seems to me that if we are to achieve significant fiscal reform, that we do need to treat all areas equally, in a sense. There is not one of the 13 annual appropriation bills that can't be reformed or improved. But, beyond that, it seems to me that regardless what type of freeze we achieve, that the true reforms will have to

be instituted in a post-freeze atmosphere. The current debate on agricultural reform is necessary and useful. But, getting back to Senator McClure's statement, until we take into consideration what we are going to do regarding the international trade picture, we will once again only be patching agriculture with a Band-Aid. It is imperative that we consider what happens in the trade world when we consider our 4-year farm bill. Any legislation that doesn't take trade into consideration will be no more than a short-term patchwork that will not achieve long-lasting reform.

Mr. STOCKMAN. Senator, if I can just respond, I hear what you are saying; I think this proposal of freeze now and then we will do the hard stuff later is a very dangerous idea. It is a copout. It will not do the job in terms of the job needed.

You say exempt Social Security. If you exempt Social Security, as we have, you are not going to freeze SSI COLA's, I don't think, or veterans pensions. You might talk about freezing defense, and that isn't going to happen, and you know it. So you get $25 billion out of freezing everything else. At best, that isn't even close to the 50 we need the first year. It wouldn't even put you in the ballpark of the $100 billion you need in the third year. So you have to go into the freeze and get into eliminating or reforming and cutting back below a freeze level some large Government expenditures.

If you do that, you have to put everything on the table together or people aren't going to be willing to make changes. Some things can't be frozen at all, obviously, like defense.

### BUDGET REFORM NOT ALL-ENCOMPASSING

Senator MATTINGLY. But it is obvious that even though we would like to achieve a concensus as soon as possible that we are not going to be able to do that by the time this bill eventually is reported out of the Budget Committee.

Mr. STOCKMAN. I think we should work triple shifts if we have to, all spring, and we can get a farm bill written and a civil service retirement bill, and we can realign student aid. We can do all of these things if we are willing to work long enough and hard enough at it. But we have to do it all at once or you are going to say don't cut me, don't cut you. This is going to happen.

### APPROACH TO TRADE PROBLEMS

Senator MATTINGLY. In respect to trade—and I know the issue puts a lot of people to sleep—but it is critically important, somehow we need to develop a different approach to our trade problem. I don't care if it is agriculture or machine tools or whatever it may be.

We talked about talking to the Japanese. We talk to the Japanese and nothing happens. And I don't think we ought to talk just about Japan. We should include a lot of other nations in market access issues.

What ideas are being discussed in the administration? Is there any other approach other than trying to create a new Department of Trade? What I would like to see is a more direct intervention by the President

in the negotiations with other leaders of the world in trying to eliminate unfair practices, subsidies, and other barriers they may have or even we may have.

Secretary BAKER. Senator, I don't know whether you could have much more involvement on the part of the President than he had with Nakasone in January. That is what the whole meeting was about.

We are working on that. The President is involved personally. I think he shares your view we ought to do everything we can to reduce that trade deficit.

PROPOSED NEW TRADE TALKS

Senator MATTINGLY. I know my time is up. I know he is asking for new talks on trade. Do you have any idea, any speculation about the time when that will be coming up?

Secretary BAKER. A new round for the GATT?

Senator MATTINGLY. Yes.

Secretary BAKER. No, I don't. I couldn't give you a date on that. But the discussions, as you know, with Japan in the four sectors are proceeding right now.

Senator MATTINGLY. This year?

Secretary BAKER. Our view is we would like to see an agreement this year to launch a new round in 1986.

Senator MATTINGLY. Thank you. Thank you, Mr. Chairman.

Chairman HATFIELD. Thank you, Senator.

Senator DeConcini?

STATEMENT OF SENATOR DECONCINI

AREAS OF BLAME FOR BUDGET DEFICIT

Senator DECONCINI. Mr. Chairman, referring back to the argument the Senator from Connecticut and the Senator from Idaho made on the balanced budget amendment, I happen to be one that supports it and regret that we can't have it implemented today, or a couple years ago when we did pass it in the Senate.

It always troubles me when everybody wants to look back at the Congress. You know, the President under the Constitution has a right to veto any of these bills. He has vetoed fewer bills than almost any President in recent history. The Budget Act requires the President to submit a budget. These are his budgets we are working on. These are his deficits we are working on.

I just get a little tired of taking the full brunt of it. I think we are all in this boat together. Either we are going to hang together or hang separately. To be fair in this process, it really troubles me that the President is constantly pointing the finger here at the Hill, when I think the finger deserves to be pointed both places.

In the beginning, the budget comes up here, highly unbalanced, every single year, and the Congress gets the blame from the President for not passing a constitutional amendment or reducing the budget. As we send the bills down there he doesn't like, he doesn't seem to have the courage to veto them.

SAVINGS FROM FISCAL 1986 BUDGET FREEZE

Now, Mr. Stockman, on the subject of the freeze, what would a budget freeze at 1985 levels amount to if it were based on budget authority?

Mr. STOCKMAN. Well, Senator, I assume you are freezing the cost-of-living adjustments.

Senator DECONCINI. Everything except the interest cost.

Mr. STOCKMAN. We have roughly calculated if you did it with absolute unyielding consistency, it would be about $35 billion.

Senator DECONCINI. What about outlays?

Mr. STOCKMAN. That was budget authority.

Senator DECONCINI. What about outlays then?

Mr. STOCKMAN. Well, if you did it at budget outlays, excepting that interest on the debt——

Senator DECONCINI. It is $7 billion, isn't it?

Mr. STOCKMAN. Yes. You couldn't do that for a whole variety of reasons having to do with all the money in the pipeline.

Senator DECONCINI. With that in mind, if you did it at budget authority, it is $35 billion you say?

Mr. STOCKMAN. If you did it at the program level, which is budget authority, cost-of-living adjustments——.

Senator DECONCINI. That is $35 billion.

Mr. STOCKMAN. But that includes defense and includes Social Security.

Senator DECONCINI. I understand.

Mr. STOCKMAN. That includes all the means tested.

QUICK-FIX THEORY OF BUDGET FREEZE

Senator DECONCINI. I don't understand your logic in saying that is not a good place to start, as Senator Mattingly has suggested, work from there. Why isn't that a good place to start? Doesn't that start us off with $35 billion that you don't have today? Then we could look at these programs, as you have, and debate the merits of cutting out Amtrak or not cutting out Amtrak or whatever? Why isn't that a reasonable approach to take because of the tremendous deficit problem we are facing today?

This is not just a little problem that we are just going to coast over. I think everybody realizes it is a major problem. It just seems like $35 billion as a beginning point makes a lot of sense.

Mr. STOCKMAN. Well, Senator, as a beginning point, it is a kind of benchmark, okay. But I was referring to an ending point. I fear the argument let's freeze now and we will get on to reform or making choices like Amtrak in the by-and-by, and the by-and-by never happens. The $35 billion, first, isn't feasible and, second, won't be enough because in future years you need much more. You can only get that by reforming programs or eliminating programs.

So I would say start there for your calculation, but you will see quickly you have to go much beyond that because defense will go up and some other things have to go down.

ARGUMENTS AGAINST DEFENSE BUDGET FREEZE

Senator DECONCINI. Isn't the real problem that we can't touch defense?

Mr. STOCKMAN. I think the real answer is we cannot freeze defense budget authority. When your authorizing committees and appropriations committees look at it, they will conclude the same. It can't be done.

Senator DECONCINI. Why can't you freeze the amount of MX missiles for example?

Mr. STOCKMAN. You can freeze some quantities. That is one idea that was actually talked about downtown. But there are some things that have higher budget costs in 1986 than they did in 1985 that we have already approved.

Senator DECONCINI. But on the MX missiles, you didn't do that.

Mr. STOCKMAN. No; for obvious reasons. That request is a priority. Readiness will go up. You have new systems coming into service this year you have already approved and budgeted. You are not going to freeze those at the budget level.

Senator DECONCINI. I am not too sure you are correct. I think you may see a vote on the Floor on a freeze.

Mr. STOCKMAN. I am saying it won't be without cost.

Senator DECONCINI. I am sure it will be with cost. But you are proposing a budget that is not without cost also.

AREAS OF BUDGET SAVINGS

Mr. Stockman, I notice that part of the President's fiscal year 1986 budget calls for savings of $535 million or 10 percent by reducing agency administrative costs. Your management reform section of the budget book outlines some of the management improvements you hope to make next year to achieve some of these savings.

You also indicated in one of your budget summary books, "Background on Major Spending Reform and Reductions in 1986," on page 142, that you intend to carry over some of the travel, public relations and other savings mandated by last year's Deficit Reduction Act into fiscal 1986.

I was disappointed by the total savings that resulted from section 2901 of DEFRA and I intend to push for deeper cuts in these areas. Only 16 percent of the aggregate savings called for in the amendment in Section 2901 were achieved by the agencies.

What level of savings do you hope to achieve next year in the five administrative categories, mainly travel, consultants, public affairs, publishing and reproduction, and motor vehicles, outlined in Section 2901 of the amendment to the Budget Deficit Resolution Act?

Mr. STOCKMAN. Senator, we have a comprehensive management report coming out tomorrow which will provide in detail the result there. I think it is slightly under $500 million for all five administrative categories.

Senator DECONCINI. I take it that you are convinced that that is the maximum amount that can be achieved?

Mr. STOCKMAN. Well, you get into a problem of how many times are you going to cut the same thing. We didn't get any out of defense, although defense has two-thirds of the base in those five categories.

Senator DECONCINI. Why?

Mr. STOCKMAN. Because Congress cut our defense agreement, the Rose Garden Agreement, by $8 billion below the budget authority level we agreed to as a compromise last spring. How was that done by the Appropriations Committee? Well, at least on seven different places I found in the committee report they cut consultants. In another handful of places they cut travel. So the Appropriations Committee already did more than was required by the Deficit Reduction Act, which was moving on a different track.

Were we to come in and cut the same things again, we would have a further shortfall in the BA than they feel they need.

Senator DECONCINI. Let me see if I understand. Did the Defense Department cut their categories of travel and consultants?

Mr. STOCKMAN. No; because Congress did it in the appropriations bill.

Senator DECONCINI. All right. Then when Congress passed DEFRA, we still asked the administration to do it again. You decided that because it was already done, there wasn't any force and effect in the direction of the Congress to tell you to do it again?

INTRODUCTION OF RESCISSIONS

Mr. STOCKMAN. No. You required us to report and send up rescissions. We are. We will be sending up nothing on defense. The reason why I have summarized here. You will get the more detailed reasons tomorrow.

Senator DECONCINI. I am glad you are sending up those rescissions because I am going to introduce a bill to approve them tomorrow. But I am very disappointed that the Defense Department was totally left out of the section 2901 exercise. I hope to see that they take cuts in these particular areas.

Thank you, Mr. Chairman.

Chairman HATFIELD. Thank you, Senator.

OMB EFFORTS AT BUDGET REDUCTION

Secretary BAKER. Let me say there is no lack of aggressiveness on the part of OMB in pursuing this. They asked the Department of the Treasury to reduce the Bureau of Printing and Engraving's printing budget as part of their program to cut Government-wide printing expense.

Senator DECONCINI. I don't want to leave the impression OMB didn't try. They did. What disturbs me is defense totally escaped the intent of the amendment. OMB or the executive branch should mandate it. And next time I introduce it, it will be mandated, Mr. Stockman, so you won't have to just ask for those suggested reductions.

Chairman HATFIELD. Thank you, Senator.

Senator Abdnor?

STATEMENT OF SENATOR ABDNOR

MOTOR VEHICLE LOGGING

Senator ABDNOR. Thank you, Mr. Chairman.

Mr. Secretary, I first want to echo the comments of the Senator from Mississippi, Senator Cochran, about the IRS motor vehicle logging requirements. Apparently you issued those regulations because Congress inserted the word "contemporaneous" in the so-called Deficit Reduction Act.

Would you have objections if Congress repealed that one word?

Secretary BAKER. I don't think we would, Senator. I think that we would be concerned if in some repealing of that provision of the Deficit Reduction Act you in effect gave a blanket exemption for writing off personal automobiles. We would be concerned then.

Senator ABDNOR. I don't think we would do that. I told Assistant Secretary Pearlman I think people are basically very honest.

If taxpayers had to list their vehicles and the portion of the time they are used in business, you would get a much better picture. Anybody can fudge on the logkeeping rules and will. Some people have an awful time just keeping their balance statements.

I will be the biggest hero in South Dakota if I can repeal those rules out of existence. It is not because they are so concerned about cheating, because they don't. They are just trying to abide by the rules. I have a hunch if your revised rules had been the original regulations to start with, it would have been easier to negotiate a solution to this problem.

I have been waiting for 2 or 3 weeks now to see those new regulations. I think they were printed today.

Secretary BAKER. Yes, sir. We put them out Friday, Senator. They will permit, for instance, a farmer to keep no records and take 80 percent of his farm vehicle as business use.

Senator ABDNOR. I told my farmers we came a long way there. But you ought to try it for the businessmen going broke that only spend half their time in their cars. They may well have two cars in the family, and put 5,000 or 7,000 miles a year on their business vehicle. Try to tell them they don't use their car at least 70 percent for business. It is big trouble in my part of the country. I am dedicated to getting rid of this regulation.

PROBLEMS IN RURAL AMERICA

I would like to talk about a subject dear to my heart that Senator Cochran also brought out. I call it the forgotten economy. I have dedicated the next year and a half in the Joint Economic Committee to making people around here recognize there is a rural America.

Now about these glowing economic figures, I find no problems with them. I am sure they are all proven statistics. They sound rosy and great. But, there is not one of them that comes close to fitting rural America.

I realize that most people live in cities. But I think that we should also have a right to live in rural America. Maybe government has a

little responsibility here. I suppose some people would like to auction off first-class postal delivery, too, so that rural America can pay dearly for postage stamps, if we could even afford them.

This deregulation is a wonderful thing, except I pay twice as much to go halfway across the country as some people pay to go coast to coast. We don't even have planes out there any more in many areas. And then we hear of cutting the whole sum of $51 million in subsidies for rural air service. Let me tell you, we will not even have a carrier into our State capitol. I don't know if that speaks badly for South Dakota, but we think people ought to be able to go back and forth once in a while. [Laughter.]

We finally found a plane that would allow it, but they are paying dearly for it. They can't afford to pay much more. These air subsidies are a very vital, very important program. As a matter of fact, there are about five cities in my State which could lose air service without these subsidies.

I think this situation has existed all the way through. I don't mean to keep picking on Mr. Niskanen, but his one-page statement on rural America out of 360 pages pretty well says what I am trying to say: There are real problems out in the country.

Mr. Stockman, we have talked back and forth, but I tell you, I wouldn't want you back in South Dakota this weekend. [Laughter.] They don't agree with your statement and the insinuation it is all the farmers' fault for the problems we are in.

You know as well as I do, and you weren't in your position then, the Russian embargo didn't exactly enhance agriculture, nor was it the farmers' fault. We also had a period of rapid inflation. That is when their problems started.

Chairman HATFIELD. What is your question, Senator? I was trying to get to your question.

Senator ABDNOR. Well [laughter]. I have a lot more things I would like to point out here.

The point I want to make is—let me finish this because this is important and it was touched on today. You know, if you gentlemen try to save money, which you suggest causes some of our problems in rural America, you could look at the tax writeoff on farm losses. Mr. Secretary, this came out of your Office. In 1982 farmers showed an income of $8 billion. They showed farm losses of $16 billion. But, those losses were not from the genuine farmer.

Limiting abusive tax writeoffs by "gentlemen" farmers would be a real step in the right direction, but I have never heard anything like that out of the Government. I don't care what administration it was, I have yet to hear that food is a bargain. Everybody is worried that every time we do something, we might make consumer food prices go up.

Well, it's about time farm prices do go up. We don't keep up with inflation.

RURAL AMERICA—THE FORGOTTEN ECONOMY

My question is, do you think we are going to pay some more attention to rural America in the future, the forgotten economy? Any one of you. I am on the side of your mother, Mr. Stockman. [Laughter.]

Mr. STOCKMAN. Look, Senator, I appreciate your answer and your question. [Laughter.] I just want to say one thing. I hope you understand I never intended, nor did I say, that farmers caused their own problem or that rural America caused their own problem. Simply I wish to point out there are a lot of people in regions and industries and businesses in our society today that have big problems, if they are importing or used to export or if they are faced with the high dollar.

The question is, can the Federal Government afford to spend money to solve all of these problems? Does it have the responsibility to solve all of these problems? My answer to both questions is no. If we get the fundamentals of our finances in this Government back in order, the rest of these problems can work themselves out. But we have to start reducing what we do to solve the particular problem if we expect to alleviate the general fiscal and financial imbalance that lies behind a lot of it.

Senator ABDNOR. In time you are probably right. But by that time the main streets of these little towns will be gone as well as a good share of the farmers. I don't think that is what we want either.

Chairman HATFIELD. Thank you, Senator.

Senator Sasser?

## STATEMENT OF SENATOR SASSER

### COMPREHENSIVE RESTRUCTURING TAX SYSTEM

Senator SASSER. Thank you very much, Mr. Chairman.

Mr. Secretary, I regret that I was late and was unable to hear your statement, but I did get an opportunity to read it rapidly. I notice that you refer in your statement to the comprehensive restructuring of the tax system which was proposed I think originally by your predecessor, Mr. Regan. What modifications do you anticipate will be made in the original Treasury proposal before it comes over here to the Congress?

Secretary BAKER. Senator, beyond saying that I suspect that there will be a number of modifications, I am not prepared today to enumerate where those modifications will occur.

I am scheduled to testify on February 27 before the Ways and Means Committee and told the chairman when he invited me that I probably would be able to talk about the concept and to talk about what we hope to achieve, but again, even on February 27, not be in a position to talk about the specific changes.

In answer to the chairman's question with respect to by what date do we expect to send legislation up, I referred to the President's State of the Union Message because, quite frankly, this is such an ambitious undertaking and we don't underestimate the magnitude of the job. We don't want to tie ourselves to anything beyond a year, Senator. It is going to take quite a bit of time. It is going to take quite a bit of consultation with congressional authors and with the jurisdictional chairmen here on the Hill because we are talking about an overall comprehensive reform of our tax system.

ADMINISTRATION'S PRESS FOR TAX REFORM

Senator SASSER. It is a very comprehensive tax reform, Mr. Secretary. I want to commend the administration for the original Treasury proposals. I found them very attractive in a lot of ways. There are some areas of disagreement, but on balance, I thought it was a significant tax reform initiative.

Now my question is, how serious are we with this? Is the administration going to go into a full court press to try to get this tax reform bill passed? Do you expect to raise any additional revenues out of it?

Secretary BAKER. We are sufficiently serious, Senator, that the President put it No. 1 in his state of the Union message as the first domestic priority that he talked about. It is of equal priority, as you know, with deficit reduction.

Will we go for a full court press? The answer is yes, assuming we are able to develop a package that we think has a reasonable chance of success up here, and will receive reasonable support.

People have said let's not talk about tax reform or tax simplification until we see the President leading the charge. I think and hope and believe we will arrive at the point during the course of this year where you will see the President leading the charge.

ADDITIONAL REVENUES FROM TAX PACKAGE

Senator SASSER. Mr. Secretary, are we going to see any additional revenues raised by this tax package?

Secretary BAKER. The President said in his State of the Union Message that he preferred to see the package revenue neutral, so we don't use tax simplification as simply a disguise for raising revenue. It is his strongly held view that the way to get this deficit down is not to do it through increasing revenues but to do it on the spending side. We had a pretty extensive debate in the last national election on whether we ought to do it by cutting spending or increasing revenues. The people said no, we don't want to do it through taxes.

Senator SASSER. I have heard that many, many times, Mr. Secretary. I would submit there were other criteria on which they made their decision other than just a question of raising revenues. They don't like that. But judging from what my constituents are telling me, as I was in about 20 counties in my State this past week, they don't like the prospects of cuts in farm subsidies, they don't like the prospects of cuts in student aid, et cetera. You can go down the whole laundry list.

If at the same time we were saying no tax increases in the elections a few months ago, we had also given a laundry list of the cuts that would be made if there were no revenue increases, the decision of the American people, at least in my judgment, might not have been as clearcut. What we were hearing in November is the same thing we heard in the State of the Union Message, and that is almost no talk of the deficit problem and statements, very reassuring statements, that we can grow our way out of this difficulty. The President was saying as recently as the State of the Union Message that, indeed, we can grow out of this deficit situation that we have gotten ourselves into.

I submit, Mr. Secretary, that we here in the Congress are going to have great difficulty in convincing the American people that they have to swallow the bitter medicine of this $50 billion in spending cuts when they are getting the soothing syrup from the great communicator that it is really not necessary. You know he has told them that it is not necessary?

Secretary BAKER. Senator, I would suggest respectfully that you will see the President telling the American people that it is necessary to cut spending, telling them where it is necessary to cut spending, supporting his budget, and being out front with respect to it.

SERIOUS ATTITUDE ABOUT CUTTING DEFICITS

Senator SASSER. You have been intimately associated with this administration and been one of the architects of this policy and one of its most adroit executors. Is this administration really serious about cutting the deficit? Why should it be?

In your statement, you indicate to us that we are doing well economically. Real disposable income grew last year more than in any period in the past 21 years. GNP figures went up. Inflation figures are coming down dramatically. Everything is coming up roses for everybody except the folks down on the farm.

How serious are we about cutting this deficit and doing something about it?

Secretary BAKER. Well, we are very serious, Senator. Let me read you some other excerpts from my statement. On page 1:

> But we are faced with the need to reduce what has become an excessive rate of Federal spending. Because of that Federal spending, the prospective budget deficits that would develop in the absence of any offsetting action are far too large for our long-run economic health. We must place the Federal budget deficit on a declining path and keep it there.

I talk further about it there. Then later on, before the insert that I read with respect to revenue sharing:

> The large deficits that we face during the remainder of the decade are due to an excessive rate of Federal spending. The American people do not feel they are undertaxed. In dealing with the deficit, we are going to deal with tough decisions, but we must face up to them.

That is in my statement. The President has said the same thing and will continue to say it.

LEADERSHIP IMPORTANT TOWARD CUTTING DEFICITS

Senator SASSER. I have heard all the rhetoric and we are not exactly amateurs with rhetoric up here, as you well know. I think what we need and are going to have is some leadership from the very top if we are going to muster the fortitude to do what I suppose is necessary.

Excuse me, Mr. Chairman. I overstayed my welcome.

Secretary BAKER. I think you are going to get that leadership, Senator. I do think, though, if we start talking about raising taxes, there will be very little incentive for any of us to do the hard things that are required to cut Federal spending.

Senator SASSER. Mr. Secretary, I can assure you I am not going to talk about raising taxes, and when we get to a situation where the President comes to the Congress and presents the Reagan tax increase proposal and asks us to support it, then I might consider it, but not before then.

Chairman HATFIELD. Thank you, Senator.

Senator Specter.

## STATEMENT OF SENATOR SPECTER

### EFFECT OF CUTS ON AMTRAK

Senator SPECTER. Thank you, Mr. Chairman.

Mr. Stockman, what would happen to Amtrak if the proposed cuts go into effect?

Mr. STOCKMAN. Well, we are proposing to eliminate the subsidy entirely. Amtrak is an independent corporation. It would then have to decide what to do.

My judgment is that most of the lines would be shut down. They are simply inherently uneconomic. They require 50 cents or more on the dollar of cost in operating subsidy. But it may be feasible in some areas for limited routes or corridors for profitable operations to be reorganized. But you can't be sure. We have to leave that to a test of the marketplace and whether local governments or State governments want to fund selected segments within their areas.

Senator SPECTER. How can the Congress decide whether to agree with your proposed cut if we really have no way of knowing what will happen to Amtrak?

Mr. STOCKMAN. Because it is not worth the $800 million we spend on it. It is not an appropriate Federal responsibility. It is not needy people who use it. It is a nice thing to have if we can afford it, but clearly we can't. We don't have to do any analysis whether the cardinal is going to be shut down or not or what might be the ultimate disposition of the Northeast corridor. It is just wrong to spend that money.

Senator SPECTER. How about the line between New York and Washington?

Mr. STOCKMAN. I said the Northeast corridor line.

Senator SPECTER. If it is closed down, it is OK with you?

Mr. STOCKMAN. That is correct.

### SUBSIDIES FOR METROPOLITAN SUBWAY SYSTEMS

Senator SPECTER. What is going to happen to the subway systems in this country if subsidies for operating mass transit are eliminated, such as the District of Columbia subsidy?

Mr. STOCKMAN. Well, local governments will have to decide whether to raise fare box rates or to put local tax money into the operating subsidies. It shouldn't be a Federal responsibility. We can't afford it. We are spending $900 million a year subsidizing the fare box, a nickel in New York and a little higher in some other places, does not make sense. Another nickel in local taxes if people want to keep the fare

below a dollar in New York isn't going to break anybody. The same is true in Pennsylvania, in Washington, DC, and elsewhere. But we should not be doing it from the Federal level and implying to people that it is free. It is not.

Senator SPECTER. Do you think a 5-percent increase would keep the subways running in the District of Columbia?

Mr. STOCKMAN. I don't know about the District of Columbia. The last time I checked on New York, which is the biggest eater of subsidies, it was about a nickel a fare.

EFFECT OF CUTS ON JOB CORPS

Senator SPECTER. What is going to happen to the 40,000 people served by the Job Corps if that is eliminated?

Mr. STOCKMAN. We are suggesting that we have other skilled, trained, and manpowered programs that are a lot cheaper. That costs $14,000 a slot. We can do as good a job for $3,000 a slot under the Job Training Block Grant.

Senator SPECTER. Your statistics say it costs $15,200. Why so much?

ATTEMPT AT REDUCING JOB CORPS COSTS

Mr. STOCKMAN. Why does the Job Corps cost so much?

Senator SPECTER. Yes.

Mr. STOCKMAN. Because you have a remote campus. You have to transport people back and forth. You have a high cost infrastructure of instructors and facilities and so forth.

I admit that there is evidence that it does some good. But its cost per slot, it just can't be afforded. That is too high.

Senator SPECTER. Why can't it be reformed and cut down? $15,200 is a tremendous sum. What efforts have been made by the executive branch to reduce the cost?

Mr. STOCKMAN. We have tried to do a number of things. We have some high cost centers that are run by the Federal agencies. We like to contract those out. Every time we mention boo about it, we hear from a number of House and Senate Members who have those high cost centers in their district and they say absolutely no. Then they write it into the appropriations bill and they make it illegal for us to even consider it in some instances, so we can't do it.

The range of costs among the centers is enormous. Some of the urban based Job Corps training facilities are much more moderate in their price. But the high cost ones out in the West and elsewhere we can't seem to get anybody to take a look at.

STUDENTS ELIMINATED BY REDUCTION OF GUARANTEED STUDENT LOANS

Senator SPECTER. How many students will be cut out if we reduce the guaranteed student loans, Mr. Stockman?

Mr. STOCKMAN. We are not reducing them. There should be no reduction in the number of students. It is just those from families above $32,000 that will not get the interest subsidy. They will still get the loan, the guarantee, access to credit. They just won't get the interest subsidy.

I think a $3,000 interest subsidy is too much for people from that income level. We can't afford it.

Senator SPECTER. Isn't it true that the current amendment has changed, it is the means test now in effect so that if there is any family earning in excess of $32,500, the children from those families will not be eligible for guaranteed student loans?

Mr. STOCKMAN. No, not in what we are proposing. Now they have to take a means test, if they go to a high cost school and pass it, even if they had $100,000 in family income. What we are proposing is on a gross income basis, if you are above roughly $33,000 in family income for four, you are still eligible for GSL's, but you will have to pay the bank rate of interest, 13 percent, rather than subsidized rate of 9 percent. That is the only difference.

Senator SPECTER. It is your judgment that that will not cause a reduction in the number of students who will benefit from the guaranteed student loans?

Mr. STOCKMAN. I don't think so. If they want an education bad enough, they will have to pay a couple hundred dollars more a year. It seems to me if they want an education bad enough, that is something that is achievable.

Senator SPECTER. Mr. Chairman, I see my time has expired. May I ask one question of the Secretary?

Chairman HATFIELD. Yes.

FLAT TAX PROPOSAL

Senator SPECTER. Mr. Baker, with respect to the flat tax proposal, you say that you will not be tied down to anything beyond submission to the Congress sometime by the end of this year.

Secretary BAKER. Excuse me, Senator. I said beyond the limitations that the President expressed in his State of the Union Message. I have testified during the course of my confirmation hearings that there are some provisions in there with respect to their effect on capital formation we want to take a close look at.

Senator SPECTER. Did I understand you to say with respect to the modifications you will propose, that you would not put a date for that proposal because you don't want to be tied down to it; you will do it sometime this year?

Secretary BAKER. Yes, sir.

Senator SPECTER. Mr. Baker, there is tremendous concern around the country, I hear it all the time in my State, about the likelihood of these proposals being enacted. My response has been that it is not going to happen during the 99th Congress, to the best of my ability to make a determination. What you were saying today leads me to about that conclusion in terms of your expectation. You can only gauge one aspect.

Secretary BAKER. I hope it doesn't, Senator. That is not my intent in answering the chairman's question that way. It is simply this undertaking is of sufficient magnitude I can't sit here and tell you when we will have a specific proposal. I think it would be counterproductive to do so because if I did that and we didn't make that date, people would say, "Aha, you see, it is all over for tax reform."

That is the only reason I am resisting making such a statement. It is not because it is not going to be something I am going to be spending a substantial amount of my time on, because I am. But I would dissuade you from the view that it is a pessimistic assessment of what we might be able to do.

Senator SPECTER. But if you are saying that as Secretary of the Treasury you make no commitment to come forward with revisions, except to say you will do it sometime in the year 1985, that is a long time.

Secretary BAKER. The year means I would hope we could get it enacted this year, Senator. The President in the State of the Union Message expressed the view that with good will on all sides it could be done this year. That is what I am saying. All I am refusing to do is put a date on the submission of a specific proposal because I can't do that.

Senator SPECTER. You did not say that you would not be tied to submitting revisions except to say that you will do it sometime in 1985?

Secretary BAKER. Well, what I meant, Senator, is I would hope we could have action by the Congress in 1985. I don't want to be tied down to a specific date for submitting a legislative proposal because we may not make it.

Senator SPECTER. You wouldn't expect action from the Congress before you submit your proposal.

Secretary BAKER. No, indeed. I hope not.

Senator SPECTER. Thank you. Thank you very much, Mr. Chairman.

Chairman HATFIELD. Thank you very much.

SUBMITTED QUESTIONS

I want to thank you gentlemen. We will be submitting some questions to you in writing.

[The following questions were not asked at the hearing, but were submitted to the witnesses for response subsequent to the hearing:]

# Department of the Treasury

## Questions Submitted by Senator Hatfield

Chairman Hatfield: When will we get a tax bill?

The President in his State of the Union Address urged Congress to adopt a simplified tax plan as "an historic reform for fairness and growth," and you stated in your confirmation hearings that deficit reduction and tax reform had equal priority. When can we expect to see the Administration's tax bill?

Follow-up: What are the chances it will be enacted this year?

Follow-up: Can we afford to wait?

Secretary Baker: The Administration will come forward with recommendations shortly after we complete a four to six week review of the Treasury Department proposals and decide the appropriate format for these recommendations.

I expect tax reform legislation to be enacted this year. If the Administration and the Congress work together in a bipartisan manner, enactment this year will be assured.

We cannot afford to wait. The President has given tax simplification and reform the same high priority that he has assigned to the budget deficit issue.

Chairman Hatfield: Can we wait for a comprehensive bill?

Senator Durenberger of the Finance Committee was quoted in the Sunday Post on the subject of tax expenditures, to wit:

> "...tax expenditures are not small. The Joint committee on Taxation counts 106 items in the tax code... In 1984, those tax expenditures cost us $321 billion... In fiscal 1985, they will cost $365 billion, an increase of $44 billion in one year. That's more than the increase the President is proposing for defense. Tax expenditures will go up to $404 billion in 1986, another $39 billion increase. Up $83 billion in two years. That's more than the cost of Medicare."

Given the impact of these expenditures on the deficit, do you think we can afford to wait for a comprehensive bill? Why not have at least a "freeze" on revenue losses in the interim?

Follow-up: All right, so you won't support an overall revenue freeze. Would you at least support a freeze on any newly enacted tax expenditures? For example, your proposals for tuition tax credits and enterprise zones, which the President's budget estimates would cost $400 million in FY 86. Not much money in

the face of a $200 billion deficit, but they would lose as much revenue as you would propose to raise with a navigation user fee.

Secretary Baker: I would not support a freeze that would preclude consideration of the tax proposals contained in the President's 1986 Budget, because they are very worthwhile modifications to our current tax code. However, like every other element of the tax law, tuition tax credits and enterprise zone tax incentives would be examined within the context of a fundamentally reformed tax law.

Chairman Hatfield: Tax shelters/Lost revenue.

Recent reports have identified nearly $24 billion in lost revenue through "tax shelters"; as well IRS Commissioner Egger recently cited $90 billion that Americans failed to pay in taxes in 1981 (Post article 2/10/85). If we are not going to move substantial reform legislation, what do you plan to do administratively to collect these lost revenues, which add up to nearly double the amount the Administration is proposing to cut in spending.

Secretary Baker: I won't conjecture on a possible contingency or substitute plan should we fail to get substantive tax reform legislation through Congress this year. It is exactly because of those very facts you cite -- $24 billion in lost revenue through tax shelters and $90 billion of revenue lost in the tax gap -- that it is so important we enact tax reform legislation this year.

With lower tax rates, a more accurate measure of income, and the elimination of special tax rules that permit income from certain sources or devoted to certain uses to be taxed more favorably than other income, we will all but eliminate tax shelters and we will restore the perception of tax fairness that, in turn, will raise significantly the level of voluntary compliance with our tax laws.

I should also mention that the Treasury Department has included in its FY 1986 Budget request the beginning stage of an initiative for 2,500 additional IRS agents for each of the next three years (1987 - 89) which should result in additional revenue collections of $4.6 billion over that period.

Chairman Hatfield: Tax Cuts.

Why is the Administration unwilling to accept some revenue increases, when the President's tax cut of 1981 is responsible for over half of our current deficit?

Secretary Baker: The Administration is unwilling to accept a tax increase because the level of tax revenues is neither the cause of the deficit problem nor a part of the solution. We are not an undertaxed nation. Rather, we have a government that overspends. Low tax rates provide incentives that are necessary to maintain a high rate of real economic growth, expanding the tax base in the long run.

Chairman Hatfield: Personal vs. Corporate Tax.

Does the Administration intend to submit tax simplification for both personal income taxes and corporate taxes in a single package, or will there be an attempt to pass the politically popular personal simplification immediately, while taking on the politically difficult corporate restructuring at a later date?

Secretary Baker: The Administration intends to consider both the individual income tax and the corporate income tax in its proposals for tax simplification and reform. Generally, it is impossible to fundamentally change only one of these taxes and not also create unintended incentives that will influence the form of business organization and the way production of goods or services is carried out and financed.

Chairman Hatfield: Revenue Enhancers.

Given that the Administration is opposed to tax increases, I would like your reaction to a few revenue proposals mentioned in past debates. For the record, I am not personally or as Chairman advocating any of these specific proposals at this time, but all too often we hear of the Administration's reaction to these ideas only in the media. So, for what it's worth...

What is your reaction to a limited 25 cent per gallon federal tax on gasoline specifically designed to help reduce the deficit?

What about a one-year surcharge on taxpayers with incomes greater than $75,000?

What is your reaction to a one-year freeze in indexing?

Assuming corporate tax reform is unlikely in this fiscal year, what is your reaction to a one-year 5 percent minimum corporate tax, including banking institutions?

Again assuming no further tax reform, what does the Administration think of a 15 percent across-the-board reduction in individual and corporate tax credits preferences and deductions?

One of my favorites, since cigarette consumption is virtually inelastic as a function of price change, how about a 25 cent minimum tax in cigarettes?

Secretary Baker: My reaction to each of the tax increases you list is the same. The Administration is categorically opposed to any tax increases so there is no point to my ranking them: they are all at the bottom of my list.

Chairman Hatfield: Would the Administration be prepared in a debt crisis to support these types of taxes to help reduce pressure on further spending reduction?

Secretary Baker: You ask whether the Administration would "be prepared in a debt crisis to support these types of taxes to help reduce pressure on further spending reduction?" My answer is a

firm no. We are making every effort to increase, and not reduce, pressure on further spending reduction.

## LINE ITEM VETO-SEPARATION OF POWERS

Chairman Hatfield: Supporters of the line-item veto argue that really important items could be restored by a Congressional override vote of two-thirds. But the President could still effectively frustrate the will of a majority of Congress. Or, a President could use a line-item veto to strip a bill of the very provisions that earned it a majority of Congress in the first place. This would have serious repercussions for the balance of power in our government. Would you care to comment on that shift, given President Reagan's limited tenure in office?

Secretary Baker: There is merit in the argument that a line-item veto can help shape the composition of Federal expenditures to move toward activities preferred by the President. The President is chosen by the voters in a national election rather than by the voters from a particular Congressional district or state. Thus, in contrast to a member of Congress who must represent preferences for activities that benefit the member's regional constituency, the President represents preferences for activities that benefit the nation as a whole. Thus, a line-item veto could be expected to impact more favorably expenditures with national benefits relative to expenditures for projects with more narrow benefits.

## LINE ITEM VETO OF ENTITLEMENTS AND TAXES

Chairman Hatfield: So far, the President's idea of a line-item veto seems to encompass only discretionary, annually appropriated spending. Even if he were to apply such a line-item veto to defense spending as well as non-defense appropriations, he would only be addressing half the spending side of the ledger, and completely ignore the revenue side.

> If we are to have a line-item veto, don't you think it should also include authority to veto items of legislation providing new entitlements or creating new tax expenditures?

Secretary Baker: The President has endorsed a proposal that would authorize the President to veto individual line items in all appropriation bills, subject to the current provisions for overriding a veto of any bill. Because the President does not have this line-item veto power, the Congress can group several spending proposals which, if separate, the President might veto but would approve when combined in a more comprehensive appropriation. This practice is a problem because appropriations are presented to the President in only 13 general appropriation bills, and the President's impoundment authority is severely restricted. Although less than one-half of the Federal budget would be subject to a line-item veto, a President committed to Federal spending restraint could use this as an effective tool to reduce total spending. Restricting the current proposal to appropriations bills seems prudent because the Congress has rejected Presidential requests for even this restricted line-item veto power for over 100 years. Of course, the President retains the authority to veto entitlement bills and revenue bills that create new tax expenditures that he thinks are inappropriate.

## Office of Management and Budget

### Questions Submitted by Senator Hatfield

#### Taxes

Question: In your testimony you highlight the fact that earlier tax cuts went too far and that we have just recently restored receipts back to an appropriate level. Why then is the administration proposing additional tax proposals this year like tuition tax credits, incentives for higher education, and enterprise zones?

Answer: Tax incentives are one means by which the Federal Government pursues public policy objectives and, in most cases, can be viewed as alternatives to budget outlays, credit assistance, or other policy instruments. The proposed tax incentives that you have cited are designed to meet two important public policy objectives supported by this Administration: the improvement of economically distressed areas through private initiatives and the expansion of educational opportunities for our children.

#### Defense Freeze

Question: I must admit that I agree with your candid assessment about a defense freeze and the need for Congress to reconsider weapons systems and missions that it has supported for the past four years. I have transmitted my personal suggestions to the Armed Services Committee, but I was wondering if you could outline a few defense cuts of your own (that are not outlined in the budget)?

Follow-up: If non-defense discretionary is going down, COLAs frozen, Medicare providers frozen, can't DOD live with 3% real growth?

Answer: I, of course, support the President's budget. The President has asked the Congress to provide its ideas on the budget as well -- and this is in keeping with the normal procedure. So, I'm sure that there will be a period of discussion and exchange

of ideas on defense as well as the rest of the budget. As you know, over the past 4 years the Congress has approved 95% of President Reagan's defense budget requests.

Defense funding requests are determined by the threats facing the U.S. In view of growing Soviet capabilities, as well as our failure to improve our own defense capabilities during the decade of the seventies, we have no choice other than to increase our defense spending.

## Defense Freeze

Question: Regardless of the programmatic impact, what BA and outlay savings is OMB attributing to both a real and nominal freeze? Earlier reports were about $20 billion in outlays.

Follow-up: What budget impact would the other various proposals have such as the 3-3-3 or the 4-4-4 (real growth)?

Answer: a) The BA and Outlay savings for real and nominal budget authority (BA) freezes are shown below:

| | 1986 Savings from President's Budget | |
|---|---|---|
| | BA | Outlay |
| Nominal BA Freeze..... | $29.0B | $10.7B to $16.2B* |
| Real BA Freeze..... | $17.6B** | $6.5B to $9.9B* |

* The range of outlay savings depends on whether the BA changes are made to purchases only (the low end of the range) or across the spectrum of all Defense appropriations (the high end of the range).

** Based on the Administration's pay and purchase deflators.

b) The following savings would result from 3/3/3 real growth in Budget Authority assuming the Administration's pay and purchase deflators:

DOD-Military
Changes to the
President's Budget ($B)

| | 1986 | 1987 | 1988 |
|---|---|---|---|
| 3/3/3 BA Savings..... | -8.7 | -26.4 | -49.9 |
| Outlay Savings | | | |
| Purchases Only..... | -3.2 | -12.2 | -27.6 |
| Across the Board..... | -4.9 | -16.7 | -34.7 |

c) The following savings would result from 4/4/4 real growth in Budget Authority assuming the Administration's pay and purchase deflators:

DOD-Military
Changes to the
President's Budget ($B)

| | 1986 | 1987 | 1988 |
|---|---|---|---|
| 4/4/4 BA Savings..... | -5.8 | -20.0 | -39.5 |
| Outlay Savings | | | |
| Purchases Only..... | -2.1 | -9.0 | -18.3 |
| Across the Board..... | -3.2 | -12.5 | -27.1 |

## FY 85 RESCISSIONS

Question: The administration has submitted several major rescission requests for state and local grant programs that were enacted into law as early as August of 1984 (6 months ago). $179 million for EDA, $37 million for Coastal Zone Management Planning and $19.5 million for Sea Grant research, just to name a few. Congress is unlikely to approve such rescissions to last year's budget, at the same time the extreme delay (up to 8-9 months) in obligating money to state and local entities creates enormous hardship on their own budgets and specialized personnel running these programs. How soon after the 45 day rescission period can we expect the agencies to receive their allotments from OMB and get the money to the states?

Answer: The law requires that the funds be made available for obligation at the end of the prescribed 45-day period. Should the Congress fail to act on the rescission proposals, OMB will, as it has in the past, obey the law and release the funds immediately following the expiration of the 45-day period.

## Peace Institute

Question: Why will only $1 million be spent in FY 85 [on the U.S. Institute of Peace]?

Answer: The Institute will require time for staffing, organization, and establishing its operation. It is reasonable to assume that most of 1985 will be needed for startup, and that the Institute will not begin to obligate resources until late in the fiscal year. The $4 million in FY 1985 appropriations are available until the end of FY 1986.

Question: Why is not the full $10 million being requested in the FY 86 budget?

Answer: Because the Institute will still be in a formative stage until sometime in FY 1986, there is no need for funding above the $4 million already appropriated for fiscal years 1985 and 1986. After the Institute has been in operation for a period of time it will be possible to evaluate its funding requirements based on its program and range of activities.

Question: When will the President submit the names of the Board of Directors for the Institute?

Answer: The United States Institute of Peace Act requires the President to submit the names of nominees for initial Board membership not later than ninety days after January 20, 1985. The Administration is currently considering persons to be nominated.

Question: The authorizing legislation requires that 1/4 of the annual appropriations be used for grants. What is the administration's timetable for issuing grants required by the statute? In FY 85 and FY 86?

Answer: Until the Institute has been established, with a functioning board, President, and staff, it is not possible to state a precise timetable for issuing grants. It is

unlikely that there will be sufficient time to set up the Institute, review grant proposals, and award grants before the end of FY 85.

Major Budget Proposals

Question: Why did you not also display these savings (from current services projections) in terms of budget authority?

Will you please provide this Committee with the budget authority savings from current services in precisely the same categories that you set forth in Part 2 of your budget?

Answer: The President's proposed savings from current services projections are presented in terms of outlays in Part 2 of the budget because outlays are a more meaningful concept for the budget totals. For most discretionary appropriations, budget authority is the means used to control program levels. Thus, from a decision-making point of view, budget authority for these programs may be considered more important than outlays. However, for many programs budget authority is to the point of control. Entitlements and other mandatory programs require changes in the eligibility criteria and benefit levels established in substantive law in order to achieve program savings. In the case of trust funds, budget authority simply represents receipts. For other programs, limitations on obligations or loan guarantee commitments are required. In addition, even for those programs that are controlled by budget authority, reductions in budget authority in one year do not translate directly into outlay reductions in that year because budget authority typically is spent over a period of more than one year. For all of these reasons, savings in total budget authority would not be a meaningful measure of total deficit reductions.

The attached table presents the proposed budget authority cuts by major Part 2 category. More detailed data, showing cuts in budget authority by Part 2 subcategories, are shown in the attached computer report:

PROPOSED BUDGET AUTHORITY CUTS
(in billions of dollars)

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | Total 1986-88 | Total 1986-90 |
|---|---|---|---|---|---|---|---|---|
| National defense: | | | | | | | | |
| Current services..... | 292.1 | 333.6 | 371.9 | 421.4 | 460.6 | 501.5 | 1,127.0 | 2,089.1 |
| Policy change..... | +0.4 | -11.4 | -8.7 | -10.0 | -11.8 | -13.4 | -30.0 | -55.2 |
| Budget..... | 292.6 | 322.2 | 363.3 | 411.5 | 448.9 | 488.1 | 1,096.9 | 2,033.9 |
| Entitlements and other mandatory: | | | | | | | | |
| Social security: | | | | | | | | |
| Current services..... | 195.9 | 210.4 | 224.2 | 264.5 | 292.5 | 324.1 | 699.0 | 1,315.7 |
| Policy change..... | --- | +0.2 | -0.4 | -0.2 | +0.4 | -0.5 | -0.4 | -0.5 |
| Budget..... | 195.9 | 210.5 | 223.8 | 264.3 | 292.9 | 323.6 | 698.6 | 1,315.2 |
| Other: | | | | | | | | |
| Current services..... | 274.9 | 286.3 | 312.7 | 327.5 | 344.1 | 362.2 | 926.4 | 1,632.7 |
| Policy change..... | +0.3 | -10.8 | -16.6 | -20.5 | -26.2 | -29.3 | -48.0 | -103.5 |
| Budget..... | 275.2 | 275.4 | 296.1 | 307.0 | 318.0 | 332.9 | 878.5 | 1,529.3 |
| Discretionary programs: | | | | | | | | |
| Current services..... | 211.1 | 196.5 | 201.0 | 209.4 | 217.8 | 221.6 | 606.8 | 1,046.2 |
| Policy change..... | -1.4 | -41.3 | -45.9 | -49.5 | -55.3 | -57.1 | -136.7 | -249.1 |
| Budget..... | 209.7 | 155.2 | 155.1 | 159.9 | 162.4 | 164.5 | 470.1 | 797.0 |

PROPOSED BUDGET AUTHORITY CUTS (continued)
(in billions of dollars)

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | Total 1986-88 | Total 1986-90 |
|---|---|---|---|---|---|---|---|---|
| Offsetting receipts: | | | | | | | | |
| Current services..... | -63.1 | -69.3 | -72.9 | -71.4 | -74.6 | -78.0 | -213.7 | -366.3 |
| Policy change..... | -0.1 | -3.6 | -3.1 | -2.9 | -2.7 | -1.9 | -9.6 | -14.2 |
| Budget..... | -63.2 | -73.0 | -76.1 | -74.3 | -77.2 | -79.9 | -223.3 | -380.4 |
| Debt service: | | | | | | | | |
| Current services..... | 154.8 | 172.8 | 190.8 | 201.8 | 195.2 | 192.7 | 565.4 | 953.3 |
| Policy change..... | -0.1 | -3.1 | -9.9 | -17.1 | -22.7 | -30.2 | -30.2 | -83.1 |
| Budget..... | 154.7 | 169.7 | 180.8 | 184.7 | 172.6 | 162.5 | 535.2 | 870.3 |
| Total budget authority: | | | | | | | | |
| Current services..... | 1,065.8 | 1,130.2 | 1,227.6 | 1,353.1 | 1,435.7 | 1,524.1 | 3,710.9 | 6,670.7 |
| Policy change..... | -0.9 | -70.2 | -84.6 | -100.1 | -118.2 | -132.3 | -254.9 | -505.5 |
| Budget..... | 1,064.9 | 1,060.0 | 1,143.0 | 1,253.0 | 1,317.5 | 1,391.8 | 3,456.0 | 6,165.2 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



(B - S)

ON & OFF BUDGET

CATEGORY: ENTITLEMENTS AND OTHER MANDATORY PROGRAMS
Retirement, disability, and unemployment

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| **TOTAL, Social security** | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 195,918 | 210,356 | 224,195 | 264,472 | 292,498 | 324,146 | 699,022 | 1,315,666 |
| O..... | 188,594 | 199,761 | 213,454 | 227,667 | 242,253 | 257,450 | 640,881 | 1,140,583 |
| 2. POLICY | | | | | | | | |
| BA.... | 195,918 | 210,507 | 223,823 | 264,301 | 292,922 | 323,646 | 698,630 | 1,315,198 |
| O..... | 188,594 | 199,761 | 213,453 | 227,666 | 242,252 | 257,449 | 640,879 | 1,140,579 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | 0 | 151 | -372 | -171 | 424 | -500 | -392 | -468 |
| O..... | 0 | 0 | -1 | -1 | -1 | -1 | -2 | -4 |
| **TOTAL, Railroad retirement** | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 5,077 | 5,381 | 4,760 | 4,614 | 4,635 | 4,766 | 14,755 | 24,156 |
| O..... | 3,490 | 3,665 | 3,691 | 3,873 | 4,130 | 4,310 | 11,229 | 19,669 |
| 2. POLICY | | | | | | | | |
| BA.... | 5,077 | 5,506 | 4,814 | 4,586 | 4,636 | 4,762 | 14,906 | 24,304 |
| O..... | 3,490 | 3,631 | 3,629 | 3,790 | 4,027 | 4,187 | 11,050 | 19,264 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | 0 | 125 | 54 | -28 | 1 | -4 | 151 | 148 |
| O..... | 0 | -34 | -62 | -83 | -103 | -123 | -179 | -405 |



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CATEGORY: ENTITLEMENTS AND OTHER MANDATORY PROGRAMS
Retirement, disability, and unemployment

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| **TOTAL, Military retirement** | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 26,966 | 29,465 | 32,023 | 34,610 | 37,094 | 39,425 | 96,098 | 172,617 |
| O..... | 15,809 | 18,291 | 19,439 | 20,636 | 21,858 | 23,082 | 58,367 | 103,307 |
| 2. POLICY | | | | | | | | |
| BA.... | 27,146 | 30,031 | 33,252 | 36,483 | 39,601 | 42,292 | 99,766 | 181,659 |
| O..... | 15,860 | 17,800 | 18,726 | 19,875 | 21,048 | 22,224 | 56,402 | 99,674 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | 180 | 566 | 1,229 | 1,873 | 2,507 | 2,867 | 3,667 | 9,042 |
| O..... | 51 | -491 | -713 | -761 | -810 | -859 | -1,965 | -3,633 |
| **TOTAL, Federal employee retirement** | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 40,374 | 42,775 | 45,716 | 48,776 | 51,239 | 53,465 | 137,266 | 241,970 |
| O..... | 23,621 | 25,336 | 27,116 | 28,975 | 30,895 | 32,854 | 81,427 | 145,177 |
| 2. POLICY | | | | | | | | |
| BA.... | 40,381 | 42,080 | 44,268 | 46,882 | 49,114 | 51,221 | 133,229 | 233,564 |
| O..... | 23,621 | 24,581 | 25,682 | 26,951 | 28,237 | 29,552 | 77,214 | 135,003 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | 7 | -695 | -1,448 | -1,894 | -2,125 | -2,243 | -4,037 | -8,406 |
| O..... | 0 | -755 | -1,434 | -2,024 | -2,658 | -3,303 | -4,213 | -10,174 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



ON & OFF BUDGET

CATEGORY: ENTITLEMENTS AND OTHER MANDATORY PROGRAMS
Retirement, disability, and unemployment

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Other retirement and disability | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 11,833 | 12,572 | 12,900 | 13,286 | 13,633 | 13,957 | 38,758 | 66,348 |
| O..... | 12,187 | 12,523 | 12,832 | 13,218 | 13,566 | 13,891 | 38,573 | 66,029 |
| 2. POLICY | | | | | | | | |
| BA.... | 11,833 | 12,494 | 12,721 | 13,043 | 13,352 | 13,653 | 38,258 | 65,262 |
| O..... | 12,187 | 12,445 | 12,657 | 12,976 | 13,284 | 13,586 | 38,077 | 64,947 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | 0 | -78 | -179 | -243 | -281 | -304 | -500 | -1,086 |
| O..... | 0 | -78 | -175 | -242 | -282 | -304 | -495 | -1,082 |
| TOTAL, Unemployment | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 20,946 | 21,143 | 21,911 | 21,536 | 20,663 | 21,391 | 64,590 | 106,644 |
| O..... | 16,780 | 16,297 | 16,604 | 16,756 | 16,905 | 17,054 | 49,657 | 83,616 |
| 2. POLICY | | | | | | | | |
| BA.... | 20,987 | 21,271 | 22,096 | 21,760 | 20,963 | 21,600 | 65,128 | 107,690 |
| O..... | 16,780 | 16,294 | 16,603 | 16,761 | 16,916 | 17,068 | 49,657 | 83,641 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | 41 | 129 | 185 | 224 | 300 | 208 | 538 | 1,046 |
| O..... | 0 | -3 | -1 | 5 | 10 | 14 | 0 | 25 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



CATEGORY: ENTITLEMENTS AND OTHER MANDATORY PROGRAMS
Retirement, disability, and unemployment

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Retirement, disability, and unemployment | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 301,114 | 321,691 | 341,504 | 387,294 | 419,762 | 457,150 | 1,050,490 | 1,927,401 |
| O | 260,480 | 275,872 | 293,136 | 311,125 | 329,607 | 348,641 | 880,133 | 1,558,381 |
| 2. POLICY | | | | | | | | |
| BA | 301,342 | 321,888 | 340,973 | 387,055 | 420,588 | 457,173 | 1,049,916 | 1,927,677 |
| O | 260,532 | 274,511 | 290,750 | 308,018 | 325,763 | 344,066 | 873,279 | 1,543,108 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 228 | 197 | -531 | -239 | 826 | 23 | -573 | 276 |
| O | 51 | -1,361 | -2,386 | -3,107 | -3,844 | -4,575 | -6,854 | -15,273 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



ON & OFF BUDGET

CATEGORY: ENTITLEMENTS AND OTHER MANDATORY PROGRAMS
Medicare and Medicaid

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, HI (Part A) | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 52,683 | 62,525 | 69,554 | 69,399 | 74,663 | 80,404 | 201,474 | 356,541 |
| O | 48,085 | 50,429 | 55,218 | 61,017 | 67,558 | 74,574 | 166,664 | 308,796 |
| 2. POLICY | | | | | | | | |
| BA | 52,683 | 62,393 | 69,907 | 70,075 | 75,897 | 81,821 | 202,375 | 360,093 |
| O | 48,074 | 47,259 | 50,543 | 55,727 | 61,560 | 67,827 | 153,529 | 282,916 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 0 | -132 | 353 | 680 | 1,234 | 1,417 | 901 | 3,552 |
| O | -11 | -3,170 | -4,675 | -5,290 | -5,998 | -6,747 | -13,135 | -25,880 |
| TOTAL, SMI (Part B) | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 24,387 | 26,012 | 29,732 | 33,841 | 38,065 | 42,773 | 89,585 | 170,423 |
| O | 22,095 | 25,063 | 28,354 | 32,152 | 36,255 | 40,908 | 85,569 | 162,732 |
| 2. POLICY | | | | | | | | |
| BA | 24,389 | 25,426 | 28,767 | 32,606 | 36,444 | 40,714 | 86,799 | 163,957 |
| O | 22,084 | 24,301 | 27,410 | 30,905 | 34,623 | 38,839 | 82,616 | 156,078 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 2 | -586 | -965 | -1,235 | -1,621 | -2,059 | -2,786 | -6,466 |
| O | -11 | -762 | -944 | -1,247 | -1,632 | -2,069 | -2,953 | -6,654 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



CATEGORY: ENTITLEMENTS AND OTHER MANDATORY PROGRAMS
Medicare and Medicaid

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Premiums and collections | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | -5,547 | -5,956 | -6,889 | -7,507 | -7,967 | -8,432 | -20,352 | -36,751 |
| O..... | -5,547 | -5,956 | -6,889 | -7,507 | -7,967 | -8,432 | -20,352 | -36,751 |
| 2. POLICY | | | | | | | | |
| BA.... | -5,547 | -6,121 | -7,567 | -9,229 | -11,009 | -13,079 | -22,917 | -47,005 |
| O..... | -5,547 | -6,121 | -7,567 | -9,229 | -11,009 | -13,079 | -22,917 | -47,005 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | 0 | -165 | -678 | -1,722 | -3,042 | -4,647 | -2,565 | -10,254 |
| O..... | 0 | -165 | -678 | -1,722 | -3,042 | -4,647 | -2,565 | -10,254 |
| TOTAL, Medicaid | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 21,845 | 24,742 | 26,919 | 29,449 | 32,184 | 35,021 | 81,110 | 148,315 |
| O..... | 22,985 | 24,742 | 26,919 | 29,449 | 32,184 | 35,021 | 81,110 | 148,315 |
| 2. POLICY | | | | | | | | |
| BA.... | 21,845 | 23,690 | 24,772 | 26,187 | 27,629 | 29,067 | 74,650 | 131,346 |
| O..... | 22,985 | 23,690 | 24,772 | 26,187 | 27,629 | 29,067 | 74,650 | 131,346 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | 0 | -1,052 | -2,147 | -3,262 | -4,555 | -5,954 | -6,461 | -16,970 |
| O..... | 0 | -1,052 | -2,147 | -3,262 | -4,555 | -5,954 | -6,461 | -16,970 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



ON & OFF BUDGET

CATEGORY: ENTITLEMENTS AND OTHER MANDATORY PROGRAMS
Medicare and Medicaid

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Medicare and Medicaid | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 93,368 | 107,323 | 119,316 | 125,178 | 136,945 | 149,766 | 351,817 | 638,528 |
| O | 87,618 | 94,278 | 103,602 | 115,111 | 128,030 | 142,071 | 312,991 | 583,092 |
| 2. POLICY | | | | | | | | |
| BA | 93,370 | 105,388 | 115,880 | 119,639 | 128,961 | 138,523 | 340,907 | 608,391 |
| O | 87,595 | 89,129 | 95,158 | 103,590 | 112,803 | 122,654 | 287,877 | 523,734 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 2 | -1,935 | -3,436 | -5,539 | -7,984 | -11,243 | -10,911 | -30,138 |
| O | -22 | -5,149 | -8,444 | -11,521 | -15,227 | -19,417 | -25,114 | -59,758 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



GN & OFF BUDGET

CATEGORY: ENTITLEMENTS AND OTHER MANDATORY PROGRAMS
Means-tested

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, AFDC/CSE | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 8,919 | 8,978 | 9,516 | 9,734 | 9,986 | 10,105 | 28,228 | 48,319 |
| O..... | 8,970 | 9,063 | 9,515 | 9,734 | 9,985 | 10,105 | 28,313 | 48,403 |
| 2. POLICY | | | | | | | | |
| BA.... | 8,919 | 8,746 | 9,312 | 9,539 | 9,801 | 9,927 | 27,597 | 47,325 |
| O..... | 8,970 | 8,827 | 9,312 | 9,539 | 9,801 | 9,927 | 27,678 | 47,406 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | 0 | -232 | -203 | -195 | -185 | -178 | -631 | -994 |
| O..... | 0 | -236 | -203 | -195 | -185 | -178 | -634 | -997 |
| TOTAL, SSI | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 9,210 | 9,860 | 10,299 | 11,591 | 11,241 | 10,791 | 31,750 | 53,782 |
| O..... | 8,613 | 8,971 | 9,363 | 10,636 | 10,268 | 9,802 | 28,970 | 49,039 |
| 2. POLICY | | | | | | | | |
| BA.... | 9,210 | 9,861 | 10,279 | 11,542 | 11,166 | 10,695 | 31,682 | 53,543 |
| O..... | 8,611 | 8,971 | 9,363 | 10,636 | 10,268 | 9,802 | 28,969 | 49,039 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | 0 | 1 | -20 | -49 | -75 | -97 | -68 | -240 |
| O..... | -3 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



ON & OFF BUDGET

CATEGORY: ENTITLEMENTS AND OTHER MANDATORY PROGRAMS
Means-tested

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Food Stamps | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 12,577 | 12,714 | 13,180 | 13,714 | 14,200 | 14,590 | 39,608 | 68,398 |
| O | 12,607 | 12,705 | 13,171 | 13,705 | 14,192 | 14,582 | 39,587 | 68,356 |
| 2. POLICY | | | | | | | | |
| BA | 12,568 | 12,681 | 13,125 | 13,635 | 14,114 | 14,497 | 39,441 | 68,051 |
| O | 12,599 | 12,684 | 13,117 | 13,627 | 14,106 | 14,490 | 39,429 | 68,025 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | -9 | -33 | -55 | -79 | -86 | -94 | -167 | -347 |
| O | -9 | -21 | -54 | -78 | -85 | -93 | -153 | -331 |
| TOTAL, Child nutrition | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 3,822 | 4,126 | 4,469 | 4,815 | 5,170 | 5,543 | 13,410 | 24,123 |
| O | 3,852 | 4,115 | 4,451 | 4,796 | 5,151 | 5,522 | 13,362 | 24,035 |
| 2. POLICY | | | | | | | | |
| BA | 3,822 | 3,440 | 3,550 | 3,803 | 4,085 | 4,364 | 10,793 | 19,241 |
| O | 3,852 | 3,467 | 3,544 | 3,789 | 4,069 | 4,348 | 10,800 | 19,218 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 0 | -686 | -919 | -1,012 | -1,085 | -1,179 | -2,617 | -4,882 |
| O | 0 | -648 | -906 | -1,007 | -1,081 | -1,174 | -2,561 | -4,817 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



ON & OFF BUDGET

CATEGORY: ENTITLEMENTS AND OTHER MANDATORY PROGRAMS
Means-tested

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Guaranteed Student Loans | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 3,744 | 3,330 | 3,294 | 2,892 | 2,524 | 2,456 | 9,515 | 14,495 |
| O | 3,431 | 3,310 | 3,301 | 2,972 | 2,598 | 2,469 | 9,583 | 14,650 |
| 2. POLICY | | | | | | | | |
| BA | 3,744 | 2,714 | 2,929 | 2,523 | 2,266 | 2,162 | 8,167 | 12,595 |
| O | 3,324 | 2,898 | 2,913 | 2,605 | 2,317 | 2,183 | 8,416 | 12,916 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 0 | -615 | -364 | -369 | -258 | -293 | -1,348 | -1,899 |
| O | -107 | -412 | -388 | -368 | -280 | -286 | -1,167 | -1,734 |
| TOTAL, Earned income tax credit | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 1,054 | 1,255 | 1,175 | 1,112 | 1,075 | 1,000 | 3,542 | 5,617 |
| O | 1,054 | 1,255 | 1,175 | 1,112 | 1,075 | 1,000 | 3,542 | 5,617 |
| 2. POLICY | | | | | | | | |
| BA | 1,054 | 1,255 | 1,175 | 1,112 | 1,075 | 1,000 | 3,542 | 5,617 |
| O | 1,054 | 1,255 | 1,175 | 1,112 | 1,075 | 1,000 | 3,542 | 5,617 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| O | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |

CATEGORY: ENTITLEMENTS AND OTHER MANDATORY PROGRAMS
Means-tested

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Veterans pensions | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 3,811 | 3,838 | 3,836 | 3,861 | 3,885 | 3,903 | 11,535 | 19,323 |
| O | 3,847 | 3,833 | 3,835 | 3,860 | 3,884 | 3,902 | 11,528 | 19,314 |
| 2. POLICY | | | | | | | | |
| BA | 3,811 | 3,838 | 3,836 | 3,861 | 3,885 | 3,903 | 11,535 | 19,323 |
| O | 3,847 | 3,833 | 3,835 | 3,860 | 3,884 | 3,902 | 11,528 | 19,314 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| O | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| TOTAL, Means-tested | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 43,137 | 44,100 | 45,769 | 47,719 | 48,081 | 48,389 | 137,588 | 234,058 |
| O | 42,374 | 43,253 | 44,811 | 46,815 | 47,152 | 47,383 | 134,879 | 229,414 |
| 2. POLICY | | | | | | | | |
| BA | 43,129 | 42,535 | 44,207 | 46,015 | 46,391 | 46,547 | 132,757 | 225,695 |
| O | 42,256 | 41,935 | 43,260 | 45,167 | 45,521 | 45,652 | 130,363 | 221,535 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | -9 | -1,565 | -1,562 | -1,704 | -1,689 | -1,841 | -4,831 | -8,362 |
| O | -119 | -1,318 | -1,551 | -1,648 | -1,632 | -1,731 | -4,516 | -7,879 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



ON & OFF BUDGET

CATEGORY: ENTITLEMENTS AND OTHER MANDATORY PROGRAMS
Other Mandatory

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Farm price support | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 13,048 | 11,536 | 14,605 | 15,605 | 15,410 | 15,112 | 41,746 | 72,268 |
| O | 15,081 | 12,580 | 14,605 | 15,605 | 15,410 | 15,112 | 42,790 | 73,312 |
| 2. POLICY | | | | | | | | |
| BA | 13,048 | 9,495 | 8,469 | 7,705 | 3,869 | 3,912 | 25,669 | 33,450 |
| O | 15,081 | 10,539 | 8,469 | 7,705 | 3,869 | 3,912 | 26,713 | 34,494 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 0 | -2,041 | -6,136 | -7,900 | -11,541 | -11,200 | -16,077 | -38,818 |
| O | 0 | -2,041 | -6,136 | -7,900 | -11,541 | -11,200 | -16,077 | -38,818 |
| TOTAL, General revenue sharing | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 4,575 | 4,575 | 4,575 | 4,575 | 4,575 | 4,575 | 13,725 | 22,875 |
| O | 4,574 | 4,575 | 4,575 | 4,575 | 4,575 | 4,575 | 13,724 | 22,874 |
| 2. POLICY | | | | | | | | |
| BA | 4,575 | 6 | 0 | 0 | 0 | 0 | 6 | 6 |
| O | 4,617 | 1,168 | 1 | 0 | 0 | 0 | 1,169 | 1,169 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 0 | -4,569 | -4,575 | -4,575 | -4,575 | -4,575 | -13,719 | -22,869 |
| O | 43 | -3,407 | -4,574 | -4,575 | -4,575 | -4,575 | -12,555 | -21,705 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



ON & OFF BUDGET

CATEGORY: ENTITLEMENTS AND OTHER MANDATORY PROGRAMS
Other Mandatory

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Federal Employees Health Benefit | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 1,342 | 1,606 | 1,845 | 2,066 | 2,308 | 2,576 | 5,518 | 10,402 |
| O | 1,143 | 1,460 | 1,612 | 1,794 | 1,993 | 2,186 | 4,866 | 9,045 |
| 2. POLICY | | | | | | | | |
| BA | 1,342 | 1,606 | 1,790 | 1,896 | 1,996 | 2,092 | 5,291 | 9,379 |
| O | 1,143 | 1,460 | 1,674 | 1,742 | 1,737 | 1,795 | 4,876 | 8,408 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 0 | 0 | -56 | -171 | -312 | -485 | -227 | -1,023 |
| O | 0 | 0 | 62 | -53 | -256 | -391 | 9 | -637 |
| TOTAL, PBGC | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| O | -12 | 11 | 16 | 31 | 49 | 71 | 59 | 178 |
| 2. POLICY | | | | | | | | |
| BA | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| O | -157 | -174 | -191 | -202 | -213 | -225 | -568 | -1,007 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| O | -145 | -185 | -208 | -233 | -262 | -296 | -627 | -1,185 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



ON & OFF BUDGET

CATEGORY: ENTITLEMENTS AND OTHER MANDATORY PROGRAMS
Other Mandatory

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Farm Crop Insurance Fund | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 110 | 115 | 120 | 125 | 129 | 134 | 360 | 623 |
| O | 222 | 230 | 241 | 251 | 261 | 271 | 722 | 1,254 |
| 2. POLICY | | | | | | | | |
| BA | 160 | 92 | 51 | 50 | 26 | 0 | 193 | 219 |
| O | 222 | 84 | 65 | 45 | 24 | 0 | 195 | 218 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 50 | -23 | -69 | -75 | -104 | -134 | -167 | -404 |
| O | 0 | -147 | -175 | -205 | -238 | -271 | -527 | -1,036 |
| TOTAL, Other | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 14,130 | 5,674 | 9,156 | 9,396 | 9,407 | 8,602 | 24,226 | 42,235 |
| O | 6,404 | 5,904 | 4,981 | 4,797 | 3,724 | 2,707 | 15,683 | 22,113 |
| 2. POLICY | | | | | | | | |
| BA | 14,142 | 4,911 | 8,533 | 8,907 | 9,043 | 8,256 | 22,352 | 39,651 |
| O | 6,406 | 5,584 | 4,253 | 4,118 | 3,135 | 2,095 | 13,956 | 19,186 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 12 | -763 | -623 | -489 | -364 | -346 | -1,874 | -2,584 |
| O | 3 | -320 | -728 | -679 | -589 | -612 | -1,727 | -2,928 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



ON & OFF BUDGET

CATEGORY: ENTITLEMENTS AND OTHER MANDATORY PROGRAMS
Other Mandatory

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Other Mandatory | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 33,205 | 23,507 | 30,301 | 31,767 | 31,830 | 30,999 | 85,575 | 148,404 |
| O | 27,412 | 24,760 | 26,030 | 27,053 | 26,011 | 24,922 | 77,844 | 128,777 |
| 2. POLICY | | | | | | | | |
| BA | 33,266 | 16,111 | 18,843 | 18,558 | 14,934 | 14,260 | 53,511 | 82,705 |
| O | 27,312 | 18,660 | 14,272 | 13,408 | 8,551 | 7,577 | 46,340 | 62,467 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 62 | -7,396 | -11,458 | -13,209 | -16,896 | -16,739 | -32,064 | -65,699 |
| O | -99 | -6,100 | -11,758 | -13,646 | -17,460 | -17,345 | -31,504 | -66,309 |
| TOTAL, ENTITLEMENTS AND OTHER MANDATORY PROGRAMS | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 470,825 | 496,621 | 536,890 | 591,958 | 636,618 | 686,304 | 1,625,470 | 2,948,391 |
| O | 417,884 | 438,163 | 467,579 | 500,104 | 530,801 | 563,016 | 1,405,847 | 2,499,664 |
| 2. POLICY | | | | | | | | |
| BA | 471,107 | 485,923 | 519,902 | 571,266 | 610,874 | 656,504 | 1,577,091 | 2,844,469 |
| O | 417,695 | 424,246 | 443,440 | 470,183 | 492,637 | 519,949 | 1,337,858 | 2,350,444 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 283 | -10,699 | -16,988 | -20,692 | -25,744 | -29,800 | -48,379 | -103,922 |
| O | -189 | -13,928 | -24,139 | -29,921 | -38,164 | -43,068 | -67,988 | -149,219 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



ON & OFF BUDGET

CATEGORY: DISCRETIONARY PROGRAMS
Dedicated tax and business operations

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Highways | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 15,046 | 15,472 | 16,144 | 16,848 | 17,516 | 18,159 | 48,464 | 84,139 |
| O | 13,004 | 13,656 | 14,892 | 15,652 | 16,350 | 17,093 | 44,199 | 77,643 |
| 2. POLICY | | | | | | | | |
| BA | 15,046 | 15,384 | 15,352 | 15,352 | 15,353 | 15,353 | 46,089 | 76,794 |
| O | 13,003 | 13,673 | 13,986 | 14,116 | 14,581 | 14,799 | 41,776 | 71,156 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 0 | -88 | -792 | -1,495 | -2,163 | -2,806 | -2,375 | -7,344 |
| O | 0 | 17 | -905 | -1,536 | -1,770 | -2,294 | -2,424 | -6,487 |
| TOTAL, Aviation | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 5,360 | 5,485 | 5,557 | 5,703 | 5,842 | 5,976 | 16,746 | 28,564 |
| O | 4,354 | 4,759 | 5,130 | 5,224 | 5,411 | 5,544 | 15,112 | 26,068 |
| 2. POLICY | | | | | | | | |
| BA | 5,330 | 5,133 | 5,052 | 4,497 | 4,504 | 4,507 | 14,682 | 23,693 |
| O | 4,333 | 4,617 | 4,673 | 4,641 | 4,556 | 4,407 | 13,931 | 22,694 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | -30 | -352 | -506 | -1,206 | -1,338 | -1,469 | -2,064 | -4,871 |
| O | -21 | -142 | -457 | -583 | -855 | -1,138 | -1,181 | -3,174 |

CATEGORY: DISCRETIONARY PROGRAMS
Dedicated tax and business operations

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, State employment service | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 986 | 1,011 | 1,052 | 1,097 | 1,140 | 1,182 | 3,160 | 5,482 |
| O | 1,014 | 983 | 1,024 | 1,068 | 1,114 | 1,156 | 3,075 | 5,345 |
| 2. POLICY | | | | | | | | |
| BA | 945 | 941 | 955 | 974 | 994 | 1,014 | 2,870 | 4,877 |
| O | 1,001 | 930 | 944 | 962 | 982 | 1,002 | 2,836 | 4,820 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | -41 | -70 | -97 | -123 | -147 | -168 | -290 | -605 |
| O | -13 | -53 | -80 | -106 | -132 | -154 | -239 | -525 |
| TOTAL, Power marketing administration | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 89 | -64 | -12 | 14 | 58 | 77 | -62 | 73 |
| O | -304 | -437 | -473 | -365 | -399 | -464 | -1,275 | -2,139 |
| 2. POLICY | | | | | | | | |
| BA | 89 | -569 | -486 | -495 | -333 | -214 | -1,550 | -2,096 |
| O | -304 | -1,424 | -1,381 | -1,269 | -980 | -810 | -4,073 | -5,863 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | -1 | -505 | -475 | -509 | -391 | -290 | -1,488 | -2,169 |
| O | -1 | -987 | -908 | -903 | -581 | -346 | -2,798 | -3,725 |

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OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



(8 - S)

ON & OFF BUDGET

CATEGORY: DISCRETIONARY PROGRAMS
Dedicated tax and business operations

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Forest Service | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | -28 | 359 | 243 | 210 | 152 | 107 | 811 | 1,071 |
| O | 148 | 346 | 236 | 203 | 146 | 101 | 785 | 1,032 |
| 2. POLICY | | | | | | | | |
| BA | 19 | 9 | -142 | -157 | -196 | -219 | -290 | -705 |
| O | 198 | -15 | -154 | -172 | -201 | -225 | -341 | -767 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 47 | -350 | -384 | -367 | -348 | -327 | -1,101 | -1,776 |
| O | 50 | -361 | -390 | -375 | -347 | -326 | -1,126 | -1,799 |
| TOTAL, FHA | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 208 | 128 | 157 | 274 | 319 | 468 | 558 | 1,346 |
| O | -802 | -1,089 | -1,190 | -1,386 | -1,523 | -1,545 | -3,665 | -6,733 |
| 2. POLICY | | | | | | | | |
| BA | 208 | 128 | 152 | 274 | 309 | 463 | 553 | 1,326 |
| O | -802 | -1,330 | -1,546 | -1,700 | -1,768 | -1,775 | -4,576 | -8,119 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 0 | 0 | -5 | 0 | -10 | -5 | -5 | -20 |
| O | 0 | -241 | -355 | -315 | -245 | -230 | -911 | -1,386 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



ON & OFF BUDGET

CATEGORY: DISCRETIONARY PROGRAMS
Dedicated tax and business operations

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Veterans housing loan guarantees | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 307 | 405 | 308 | 369 | 272 | 221 | 1,082 | 1,575 |
| O | 425 | 384 | 288 | 352 | 275 | 224 | 1,024 | 1,523 |
| 2. POLICY | | | | | | | | |
| BA | 307 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| O | 425 | -221 | -318 | -397 | -491 | -559 | -936 | -1,986 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 0 | -405 | -308 | -369 | -272 | -221 | -1,082 | -1,575 |
| O | 0 | -605 | -606 | -749 | -766 | -783 | -1,960 | -3,509 |
| TOTAL, Surface mining reclamation | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 297 | 311 | 324 | 338 | 351 | 364 | 973 | 1,687 |
| O | 207 | 248 | 286 | 308 | 324 | 337 | 842 | 1,503 |
| 2. POLICY | | | | | | | | |
| BA | 294 | 250 | 261 | 272 | 283 | 293 | 784 | 1,359 |
| O | 207 | 239 | 268 | 265 | 269 | 271 | 771 | 1,312 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | -3 | -60 | -63 | -66 | -68 | -71 | -189 | -328 |
| O | -1 | -9 | -18 | -43 | -54 | -66 | -71 | -191 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



ON & OFF BUDGET

CATEGORY: DISCRETIONARY PROGRAMS
Dedicated tax and business operations

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL Superfund | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 592 | 611 | 613 | 618 | 612 | 614 | 1,842 | 3,068 |
| O | 422 | 548 | 600 | 620 | 590 | 590 | 1,768 | 2,948 |
| 2. POLICY | | | | | | | | |
| BA | 592 | 868 | 1,070 | 1,115 | 1,030 | 970 | 3,053 | 5,053 |
| O | 422 | 638 | 870 | 1,030 | 1,030 | 955 | 2,538 | 4,523 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 0 | 257 | 457 | 497 | 418 | 356 | 1,211 | 1,985 |
| O | 0 | 90 | 270 | 410 | 440 | 365 | 770 | 1,575 |
| TOTAL, Other | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | -1,330 | -754 | -342 | -490 | -529 | -431 | -1,586 | -2,546 |
| O | -1,219 | -650 | -436 | -581 | -623 | -524 | -1,668 | -2,814 |
| 2. POLICY | | | | | | | | |
| BA | -1,629 | -833 | -404 | -551 | -591 | -491 | -1,788 | -2,870 |
| O | -1,521 | -728 | -499 | -644 | -686 | -585 | -1,871 | -3,143 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | -299 | -79 | -61 | -61 | -62 | -60 | -202 | -324 |
| O | -302 | -77 | -63 | -63 | -64 | -62 | -204 | -329 |

CATEGORY: DISCRETIONARY PROGRAMS
Dedicated tax and business operations

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Dedicated tax and business operations | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 21,528 | 22,964 | 24,044 | 24,982 | 25,734 | 26,735 | 71,990 | 124,459 |
| O | 17,250 | 18,748 | 20,356 | 21,094 | 21,665 | 22,513 | 60,198 | 104,376 |
| 2. POLICY | | | | | | | | |
| BA | 21,201 | 21,312 | 21,810 | 21,282 | 21,353 | 21,675 | 64,403 | 107,432 |
| O | 16,962 | 16,379 | 16,844 | 16,832 | 17,291 | 17,480 | 50,055 | 84,826 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | -327 | -1,652 | -2,234 | -3,700 | -4,381 | -5,060 | -7,586 | -17,027 |
| O | -288 | -2,369 | -3,512 | -4,263 | -4,373 | -5,033 | -10,144 | -19,549 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



ON & OFF BUDGET

CATEGORY: DISCRETIONARY PROGRAMS
Forward Funded and related

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Employment/training assistance | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 3,770 | 3,777 | 3,909 | 4,038 | 4,160 | 4,285 | 11,724 | 20,169 |
| O | 3,652 | 3,689 | 3,746 | 3,847 | 3,981 | 4,098 | 11,282 | 19,362 |
| 2. POLICY | | | | | | | | |
| BA | 3,514 | 2,806 | 2,906 | 2,906 | 2,906 | 2,906 | 8,617 | 14,428 |
| O | 3,638 | 3,551 | 3,002 | 2,890 | 2,903 | 2,906 | 9,443 | 15,252 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | -256 | -971 | -1,004 | -1,132 | -1,255 | -1,379 | -3,107 | -5,741 |
| O | -14 | -138 | -743 | -958 | -1,078 | -1,193 | -1,839 | -4,111 |
| TOTAL, Compensatory education | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 3,696 | 3,866 | 4,036 | 4,197 | 4,352 | 4,513 | 12,098 | 20,964 |
| O | 3,566 | 3,801 | 3,875 | 4,007 | 4,169 | 4,326 | 11,683 | 20,179 |
| 2. POLICY | | | | | | | | |
| BA | 3,696 | 3,647 | 3,753 | 3,887 | 4,015 | 4,149 | 11,287 | 19,451 |
| O | 3,566 | 3,787 | 3,698 | 3,738 | 3,864 | 3,994 | 11,223 | 19,081 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 0 | -219 | -282 | -310 | -337 | -365 | -812 | -1,513 |
| O | 0 | -13 | -178 | -269 | -305 | -333 | -460 | -1,098 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



ON & OFF BUDGET

CATEGORY: DISCRETIONARY PROGRAMS
Forward Funded and related

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Education for the handicapped | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 1,321 | 1,382 | 1,443 | 1,500 | 1,556 | 1,613 | 4,325 | 7,494 |
| O | 1,403 | 1,247 | 1,374 | 1,429 | 1,487 | 1,543 | 4,050 | 7,080 |
| 2. POLICY | | | | | | | | |
| BA | 1,321 | 1,306 | 1,353 | 1,400 | 1,446 | 1,493 | 4,060 | 6,999 |
| O | 1,403 | 1,241 | 1,312 | 1,343 | 1,388 | 1,434 | 3,896 | 6,719 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 0 | -76 | -90 | -100 | -110 | -120 | -265 | -495 |
| O | 0 | -6 | -62 | -86 | -99 | -109 | -153 | -362 |
| TOTAL, Vocational and adult education | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 838 | 877 | 915 | 951 | 986 | 1,022 | 2,743 | 4,751 |
| O | 914 | 859 | 875 | 904 | 939 | 975 | 2,637 | 4,551 |
| 2. POLICY | | | | | | | | |
| BA | 838 | 838 | 838 | 838 | 838 | 838 | 2,515 | 4,192 |
| O | 914 | 858 | 847 | 840 | 838 | 838 | 2,545 | 4,222 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 0 | -38 | -76 | -113 | -148 | -184 | -227 | -559 |
| O | 0 | -1 | -28 | -64 | -101 | -136 | -92 | -329 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



ON & OFF BUDGET

CATEGORY: DISCRETIONARY PROGRAMS
Forward Funded and related

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Other elementary and secondary | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 240 | 251 | 262 | 273 | 283 | 293 | 786 | 1,362 |
| O | 208 | 237 | 251 | 262 | 272 | 282 | 750 | 1,304 |
| 2. POLICY | | | | | | | | |
| BA | 210 | 210 | 210 | 210 | 210 | 210 | 631 | 1,051 |
| O | 208 | 213 | 210 | 210 | 210 | 210 | 633 | 1,053 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | -30 | -41 | -52 | -62 | -72 | -83 | -156 | -311 |
| O | 0 | -25 | -41 | -51 | -62 | -72 | -117 | -251 |
| TOTAL, Student financial assistance | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 4,871 | 4,835 | 5,050 | 5,255 | 5,453 | 5,658 | 15,140 | 26,251 |
| O | 4,506 | 4,771 | 4,904 | 5,079 | 5,284 | 5,485 | 14,754 | 25,523 |
| 2. POLICY | | | | | | | | |
| BA | 4,871 | 3,569 | 3,728 | 3,880 | 4,027 | 4,179 | 11,176 | 19,383 |
| O | 4,506 | 4,447 | 3,761 | 3,749 | 3,902 | 4,051 | 11,958 | 19,911 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 0 | -1,266 | -1,322 | -1,375 | -1,426 | -1,479 | -3,964 | -6,868 |
| O | 0 | -324 | -1,143 | -1,330 | -1,382 | -1,434 | -2,796 | -5,612 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



ON & OFF BUDGET

CATEGORY: DISCRETIONARY PROGRAMS
Forward Funded and related

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Other higher education | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 479 | 475 | 495 | 514 | 533 | 551 | 1,484 | 2,567 |
| O | 476 | 464 | 478 | 491 | 511 | 529 | 1,434 | 2,474 |
| 2. POLICY | | | | | | | | |
| BA | 435 | 252 | 252 | 251 | 251 | 250 | 755 | 1,255 |
| O | 456 | 405 | 298 | 257 | 251 | 250 | 960 | 1,461 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | -45 | -223 | -243 | -263 | -282 | -301 | -729 | -1,312 |
| O | -20 | -60 | -180 | -234 | -260 | -279 | -474 | -1,013 |
| TOTAL, National Institutes of Health | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 5,149 | 5,366 | 5,577 | 5,786 | 5,987 | 6,179 | 16,729 | 28,894 |
| O | 4,680 | 5,090 | 5,161 | 5,357 | 5,541 | 5,719 | 15,608 | 26,868 |
| 2. POLICY | | | | | | | | |
| BA | 5,139 | 4,853 | 5,042 | 5,230 | 5,411 | 5,583 | 15,125 | 26,118 |
| O | 4,671 | 4,945 | 4,667 | 4,841 | 5,009 | 5,168 | 14,453 | 24,629 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | -10 | -514 | -534 | -556 | -576 | -596 | -1,604 | -2,776 |
| O | -9 | -144 | -494 | -517 | -533 | -551 | -1,155 | -2,238 |

CATEGORY: DISCRETIONARY PROGRAMS
Forward Funded and related

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Public Broadcasting Corporation | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 150 | 160 | 200 | 214 | 217 | 225 | 574 | 1,016 |
| O | 150 | 160 | 200 | 214 | 217 | 225 | 574 | 1,016 |
| 2. POLICY | | | | | | | | |
| BA | 150 | 160 | 186 | 214 | 246 | 283 | 560 | 1,088 |
| O | 150 | 160 | 186 | 214 | 246 | 283 | 560 | 1,088 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 0 | 0 | -14 | 0 | 29 | 58 | -14 | 73 |
| O | 0 | 0 | -14 | 0 | 29 | 58 | -14 | 73 |
| TOTAL, Community service employment for older Americans | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 326 | 326 | 326 | 326 | 326 | 326 | 978 | 1,630 |
| O | 319 | 326 | 326 | 326 | 326 | 326 | 978 | 1,630 |
| 2. POLICY | | | | | | | | |
| BA | 326 | 326 | 326 | 326 | 326 | 326 | 978 | 1,630 |
| O | 319 | 326 | 326 | 326 | 326 | 326 | 978 | 1,630 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| O | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



ON & OFF BUDGET

CATEGORY: DISCRETIONARY PROGRAMS
Forward Funded and related

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Forward Funded and related | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 20,841 | 21,314 | 22,213 | 23,054 | 23,853 | 24,666 | 66,580 | 115,099 |
| O | 19,875 | 20,643 | 21,190 | 21,916 | 22,728 | 23,509 | 63,749 | 109,986 |
| 2. POLICY | | | | | | | | |
| BA | 20,500 | 17,966 | 18,594 | 19,142 | 19,676 | 20,218 | 55,703 | 95,596 |
| O | 19,831 | 19,933 | 18,308 | 18,409 | 18,937 | 19,460 | 56,649 | 95,047 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | -341 | -3,348 | -3,618 | -3,911 | -4,177 | -4,448 | -10,877 | -19,503 |
| O | -43 | -711 | -2,882 | -3,507 | -3,791 | -4,049 | -7,100 | -14,940 |

CATEGORY DISCRETIONARY PROGRAMS
Construction and site location

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Mass transit | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 4,100 | 4,203 | 4,356 | 4,510 | 4,293 | 4,178 | 13,069 | 21,540 |
| O | 4,134 | 4,015 | 3,560 | 3,919 | 4,140 | 4,156 | 11,493 | 19,789 |
| 2. POLICY | | | | | | | | |
| BA | 4,100 | 1,350 | 1,370 | 1,370 | 1,330 | 1,120 | 4,089 | 6,538 |
| O | 4,134 | 3,252 | 2,235 | 1,815 | 1,561 | 1,445 | 7,301 | 10,308 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 0 | -2,853 | -2,986 | -3,140 | -2,964 | -3,058 | -8,980 | -15,002 |
| O | 0 | -763 | -1,325 | -2,104 | -2,578 | -2,711 | -4,192 | -9,481 |
| TOTAL, Community development block grants | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 3,472 | 3,468 | 3,628 | 3,787 | 3,939 | 4,084 | 10,883 | 18,906 |
| O | 3,900 | 3,527 | 3,498 | 3,538 | 3,683 | 3,839 | 10,563 | 18,085 |
| 2. POLICY | | | | | | | | |
| BA | 3,472 | 3,125 | 3,278 | 3,412 | 3,549 | 3,680 | 9,815 | 17,044 |
| O | 3,900 | 3,520 | 3,360 | 3,216 | 3,324 | 3,460 | 10,096 | 16,880 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 0 | -343 | -350 | -375 | -390 | -404 | -1,068 | -1,862 |
| O | 0 | -7 | -137 | -322 | -360 | -379 | -466 | -1,205 |

CATEGORY DISCRETIONARY PROGRAMS
Construction and slow spending

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Urban development action grants | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 440 | 440 | 460 | 480 | 500 | 518 | 1,380 | 2,399 |
| O | 500 | 544 | 553 | 546 | 498 | 471 | 1,643 | 2,612 |
| 2. POLICY | | | | | | | | |
| BA | 440 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| O | 500 | 522 | 442 | 320 | 152 | 0 | 1,284 | 1,436 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 0 | -440 | -460 | -480 | -500 | -518 | -1,380 | -2,399 |
| O | 0 | -22 | -111 | -226 | -346 | -471 | -359 | -1,176 |
| TOTAL, Rural water grants and other FmHA | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 549 | 545 | 559 | 574 | 588 | 601 | 1,678 | 2,867 |
| O | 590 | 567 | 594 | 553 | 568 | 573 | 1,713 | 2,854 |
| 2. POLICY | | | | | | | | |
| BA | 548 | 253 | 185 | 157 | 126 | 105 | 595 | 826 |
| O | 589 | 445 | 394 | 271 | 192 | 125 | 1,109 | 1,426 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | -1 | -292 | -374 | -417 | -462 | -496 | -1,083 | -2,041 |
| O | -1 | -123 | -200 | -282 | -376 | -448 | -604 | -1,428 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



CATEGORY: DISCRETIONARY PROGRAMS
Construction and slow spending

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Other community development | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 469 | 647 | 675 | 702 | 729 | 755 | 2,025 | 3,509 |
| O | 706 | 823 | 815 | 734 | 692 | 712 | 2,372 | 3,776 |
| 2. POLICY | | | | | | | | |
| BA | 189 | 39 | 43 | 200 | 202 | 203 | 282 | 687 |
| O | 679 | 644 | 476 | 186 | 157 | 211 | 1,306 | 1,674 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | -280 | -608 | -632 | -503 | -527 | -552 | -1,743 | -2,822 |
| O | -27 | -179 | -339 | -548 | -535 | -501 | -1,066 | -2,102 |
| TOTAL, Housing | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 11,328 | 10,743 | 11,028 | 11,397 | 11,752 | 12,096 | 33,168 | 57,016 |
| O | 10,282 | 11,033 | 11,521 | 12,055 | 12,586 | 13,087 | 34,608 | 60,282 |
| 2. POLICY | | | | | | | | |
| BA | 11,328 | 519 | 1,911 | 5,745 | 5,993 | 6,189 | 8,175 | 20,357 |
| O | 9,827 | 9,707 | 9,767 | 9,972 | 10,682 | 11,111 | 29,447 | 51,239 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 0 | -10,224 | -9,118 | -5,652 | -5,758 | -5,907 | -24,993 | -36,659 |
| O | -455 | -1,327 | -1,753 | -2,082 | -1,905 | -1,976 | -5,162 | -9,043 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



ON & OFF BUDGET

CATEGORY: DISCRETIONARY PROGRAMS
Construction and slow spending

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Sewage construction grants | | | | | | | | |
| 1 CURRENT SERVICES | | | | | | | | |
| BA | 2,400 | 2,520 | 2,640 | 2,750 | 2,860 | 2,970 | 7,910 | 13,740 |
| O | 2,740 | 2,650 | 2,410 | 2,360 | 2,380 | 2,430 | 7,420 | 12,230 |
| 2 POLICY | | | | | | | | |
| BA | 2,400 | 2,400 | 1,800 | 1,200 | 600 | 0 | 5,400 | 6,000 |
| O | 2,740 | 2,650 | 2,380 | 2,200 | 1,930 | 1,520 | 7,230 | 10,680 |
| 3 POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 0 | -120 | -840 | -1,550 | -2,260 | -2,970 | -2,910 | -7,740 |
| O | 0 | 0 | -30 | -160 | -450 | -910 | -190 | -1,550 |
| TOTAL, Energy cons./fossil energy R and D | | | | | | | | |
| 1 CURRENT SERVICES | | | | | | | | |
| BA | 749 | 785 | 788 | 793 | 811 | 827 | 2,366 | 4,004 |
| O | 843 | 795 | 790 | 802 | 808 | 818 | 2,388 | 4,014 |
| 2 POLICY | | | | | | | | |
| BA | 744 | 348 | 397 | 401 | 404 | 407 | 1,145 | 1,957 |
| O | 837 | 631 | 497 | 449 | 449 | 452 | 1,577 | 2,477 |
| 3 POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | -4 | -437 | -391 | -393 | -406 | -419 | -1,221 | -2,047 |
| O | -5 | -164 | -293 | -353 | -360 | -367 | -811 | -1,537 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



ON & OFF BUDGET

CATEGORY: DISCRETIONARY PROGRAMS
Construction and slow spending

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Veterans hospital construction | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 803 | 1,188 | 1,916 | 1,999 | 1,798 | 1,926 | 5,103 | 8,826 |
| O | 583 | 791 | 1,137 | 1,238 | 1,390 | 1,600 | 3,166 | 6,155 |
| 2. POLICY | | | | | | | | |
| BA | 803 | 634 | 779 | 848 | 878 | 914 | 2,260 | 4,052 |
| O | 583 | 762 | 822 | 880 | 934 | 920 | 2,464 | 4,317 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 0 | -555 | -1,137 | -1,151 | -920 | -1,012 | -2,842 | -4,774 |
| O | 0 | -29 | -315 | -358 | -456 | -681 | -702 | -1,838 |
| TOTAL, Rural conservation | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 233 | 243 | 253 | 262 | 272 | 281 | 758 | 1,311 |
| O | 242 | 273 | 251 | 257 | 265 | 270 | 781 | 1,316 |
| 2. POLICY | | | | | | | | |
| BA | 232 | 7 | 0 | 0 | 0 | 0 | 7 | 7 |
| O | 242 | 172 | 40 | 27 | 19 | 10 | 239 | 268 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 0 | -235 | -253 | -262 | -272 | -281 | -750 | -1,303 |
| O | 0 | -102 | -211 | -229 | -246 | -260 | -542 | -1,047 |

CATEGORY: DISCRETIONARY PROGRAMS
Construction and slow spending

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Water resources | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 4,085 | 4,200 | 4,366 | 4,496 | 4,460 | 4,437 | 13,063 | 21,959 |
| O..... | 4,464 | 4,373 | 4,337 | 4,462 | 4,429 | 4,411 | 13,172 | 22,012 |
| 2. POLICY | | | | | | | | |
| BA.... | 4,062 | 3,695 | 4,099 | 4,308 | 4,446 | 4,540 | 12,102 | 21,088 |
| O..... | 4,437 | 4,169 | 4,158 | 4,323 | 4,454 | 4,546 | 12,650 | 21,650 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | -23 | -505 | -267 | -188 | -14 | 103 | -960 | -871 |
| O..... | -27 | -205 | -179 | -139 | 25 | 135 | -522 | -362 |
| TOTAL, Other slow | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 11,198 | 11,626 | 11,989 | 12,170 | 12,550 | 12,899 | 35,785 | 61,234 |
| O..... | 9,565 | 10,988 | 11,997 | 12,246 | 12,339 | 12,323 | 35,233 | 59,896 |
| 2. POLICY | | | | | | | | |
| BA.... | 11,437 | 11,215 | 11,407 | 10,084 | 10,139 | 10,310 | 32,706 | 53,154 |
| O..... | 9,587 | 10,971 | 11,614 | 11,289 | 10,922 | 10,429 | 33,874 | 55,225 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | 239 | -411 | -582 | -2,086 | -2,412 | -2,589 | -3,079 | -8,079 |
| O..... | 22 | -18 | -383 | -959 | -1,417 | -1,894 | -1,359 | -4,671 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



ON & OFF BUDGET

CATEGORY: DISCRETIONARY PROGRAMS
Construction and slow spending

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Construction and slow spending | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 39,826 | 40,608 | 42,658 | 43,921 | 44,551 | 45,571 | 127,187 | 217,309 |
| O..... | 38,549 | 40,379 | 41,461 | 42,712 | 43,778 | 44,691 | 124,552 | 213,020 |
| 2. POLICY | | | | | | | | |
| BA.... | 39,756 | 23,585 | 25,269 | 27,724 | 27,667 | 27,467 | 76,577 | 131,710 |
| O..... | 38,055 | 37,442 | 36,185 | 34,949 | 34,775 | 34,228 | 108,576 | 177,580 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | -70 | -17,024 | -17,389 | -16,197 | -16,884 | -18,105 | -50,610 | -85,599 |
| O..... | -494 | -2,937 | -5,276 | -7,763 | -9,003 | -10,462 | -15,976 | -35,441 |

CATEGORY: DISCRETIONARY PROGRAMS
Fast

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Strategic petroleum reserve | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 2,050 | 1,978 | 1,894 | 1,918 | 1,965 | 179 | 5,790 | 7,935 |
| O | 1,901 | 2,029 | 1,929 | 1,909 | 1,939 | 1,245 | 5,868 | 9,051 |
| 2. POLICY | | | | | | | | |
| BA | 2,050 | 0 | 43 | 139 | 136 | 130 | 182 | 449 |
| O | 1,901 | 379 | 172 | 140 | 138 | 132 | 690 | 960 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 0 | -1,978 | -1,851 | -1,779 | -1,829 | -49 | -5,608 | -7,486 |
| O | 0 | -1,650 | -1,758 | -1,770 | -1,801 | -1,113 | -5,177 | -8,092 |
| TOTAL, Social services and related | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 7,636 | 7,838 | 8,063 | 8,286 | 8,502 | 8,710 | 24,187 | 41,398 |
| O | 7,424 | 7,674 | 7,987 | 8,203 | 8,421 | 8,630 | 23,864 | 40,915 |
| 2. POLICY | | | | | | | | |
| BA | 7,634 | 6,630 | 6,786 | 6,920 | 7,050 | 7,175 | 20,336 | 34,561 |
| O | 7,422 | 6,785 | 6,742 | 6,865 | 6,997 | 7,124 | 20,392 | 34,513 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | -2 | -1,207 | -1,277 | -1,366 | -1,452 | -1,535 | -3,851 | -6,837 |
| O | -2 | -889 | -1,245 | -1,338 | -1,424 | -1,506 | -3,472 | -6,402 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



(8 - S)

ON & OFF BUDGET

CATEGORY: DISCRETIONARY PROGRAMS
Fast

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Low income energy ass stance | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 2,100 | 2,192 | 2,284 | 2,376 | 2,463 | 2,547 | 6,852 | 11,863 |
| O..... | 2,100 | 2,192 | 2,284 | 2,376 | 2,463 | 2,547 | 6,852 | 11,863 |
| 2. POLICY | | | | | | | | |
| BA.... | 2,100 | 1,291 | 1,331 | 1,371 | 1,408 | 1,440 | 3,993 | 6,840 |
| O..... | 2,100 | 1,291 | 1,331 | 1,371 | 1,408 | 1,440 | 3,993 | 6,840 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | 0 | -902 | -953 | -1,004 | -1,056 | -1,107 | -2,860 | -5,023 |
| O..... | 0 | -902 | -953 | -1,004 | -1,056 | -1,107 | -2,860 | -5,023 |
| TOTAL, Veterans medical care | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 9,127 | 9,739 | 10,345 | 10,975 | 11,527 | 12,069 | 31,059 | 54,656 |
| O..... | 9,050 | 9,616 | 10,217 | 10,844 | 11,393 | 11,932 | 30,677 | 54,002 |
| 2. POLICY | | | | | | | | |
| BA.... | 9,115 | 9,333 | 9,573 | 9,925 | 10,127 | 10,399 | 28,831 | 49,357 |
| O..... | 9,037 | 9,296 | 9,541 | 9,878 | 10,098 | 10,362 | 28,715 | 49,176 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | -13 | -406 | -772 | -1,049 | -1,400 | -1,671 | -2,228 | -5,299 |
| O..... | -13 | -320 | -678 | -966 | -1,295 | -1,570 | -1,961 | -4,826 |

CATEGORY DISCRETIONARY PROGRAMS
Fast

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Public and Indian housing | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 15,787 | 3,128 | 3,234 | 2,782 | 2,466 | 2,199 | 9,144 | 13,809 |
| O | 16,178 | 3,406 | 3,389 | 2,925 | 2,594 | 2,324 | 9,719 | 14,637 |
| 2. POLICY | | | | | | | | |
| BA | 15,184 | 2,832 | 2,394 | 1,633 | 1,414 | 1,268 | 6,859 | 9,541 |
| O | 15,702 | 3,090 | 2,540 | 1,775 | 1,479 | 1,490 | 7,405 | 10,374 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | -604 | -295 | -840 | -1,149 | -1,051 | -931 | -2,284 | -4,267 |
| O | -476 | -316 | -849 | -1,149 | -1,114 | -834 | -2,314 | -4,263 |
| TOTAL, Health block grant and training | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 3,273 | 3,370 | 3,468 | 3,565 | 3,662 | 3,756 | 10,403 | 17,821 |
| O | 3,134 | 3,326 | 3,459 | 3,585 | 3,707 | 3,825 | 10,370 | 17,903 |
| 2. POLICY | | | | | | | | |
| BA | 3,266 | 2,845 | 2,921 | 3,000 | 3,080 | 3,160 | 8,765 | 15,005 |
| O | 3,127 | 3,014 | 2,904 | 2,964 | 3,065 | 3,158 | 8,902 | 15,124 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | -6 | -526 | -548 | -565 | -582 | -596 | -1,638 | -2,816 |
| O | -6 | -312 | -555 | -601 | -643 | -667 | -1,469 | -2,778 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



ON & OFF BUDGET

CATEGORY: DISCRETIONARY PROGRAMS
Fast

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Amtrak | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 684 | 717 | 750 | 783 | 814 | 844 | 2,249 | 3,908 |
| O..... | 692 | 774 | 807 | 840 | 811 | 842 | 2,420 | 4,073 |
| 2. POLICY | | | | | | | | |
| BA.... | 684 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| O..... | 692 | 200 | 0 | 0 | 0 | 0 | 200 | 200 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | 0 | -717 | -750 | -783 | -814 | -844 | -2,249 | -3,908 |
| O..... | 0 | -574 | -807 | -840 | -811 | -842 | -2,220 | -3,873 |
| TOTAL, Economic support fund | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 3,841 | 4,010 | 4,178 | 4,346 | 4,506 | 4,660 | 12,534 | 21,700 |
| O..... | 3,937 | 3,900 | 4,000 | 4,190 | 4,360 | 4,500 | 12,090 | 20,950 |
| 2. POLICY | | | | | | | | |
| BA.... | 3,841 | 2,824 | 2,883 | 2,941 | 2,995 | 3,048 | 8,648 | 14,689 |
| O..... | 3,937 | 2,825 | 2,850 | 2,887 | 2,930 | 2,976 | 8,562 | 14,468 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | 0 | -1,186 | -1,295 | -1,405 | -1,511 | -1,614 | -3,886 | -7,011 |
| O..... | 0 | -1,075 | -1,150 | -1,303 | -1,430 | -1,524 | -3,528 | -6,482 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



ON & OFF BUDGET

CATEGORY: DISCRETIONARY PROGRAMS
Fast

| # | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Postal Service | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 2,443 | 2,595 | 1,244 | 1,396 | 692 | -320 | 5,235 | 5,608 |
| O | 1,361 | 1,005 | 980 | 931 | 993 | 1,050 | 2,916 | 4,959 |
| 2. POLICY | | | | | | | | |
| BA | 2,443 | 1,827 | 815 | 1,238 | 859 | 218 | 3,880 | 4,957 |
| O | 1,361 | 1,217 | 38 | 36 | 35 | 34 | 1,291 | 1,360 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 0 | -768 | -430 | -157 | 167 | 538 | -1,355 | -651 |
| O | 0 | 213 | -942 | -895 | -958 | -1,016 | -1,624 | -3,598 |
| TOTAL, Impact aid | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 695 | 728 | 762 | 795 | 827 | 858 | 2,286 | 3,971 |
| O | 747 | 762 | 761 | 787 | 818 | 849 | 2,310 | 3,977 |
| 2. POLICY | | | | | | | | |
| BA | 695 | 543 | 582 | 605 | 628 | 649 | 1,730 | 3,007 |
| O | 747 | 635 | 585 | 594 | 620 | 644 | 1,814 | 3,078 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | 0 | -185 | -180 | -190 | -200 | -209 | -556 | -964 |
| O | 0 | -127 | -176 | -193 | -198 | -205 | -496 | -899 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



ON & OFF BUDGET

CATEGORY: DISCRETIONARY PROGRAMS
Fast

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, NASA | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 7,515 | 7,954 | 8,387 | 8,761 | 9,143 | 9,530 | 25,102 | 43,775 |
| O..... | 7,321 | 7,821 | 8,183 | 8,649 | 9,007 | 9,259 | 24,652 | 42,919 |
| 2. POLICY | | | | | | | | |
| BA.... | 7,511 | 7,886 | 7,880 | 8,161 | 9,096 | 9,536 | 23,927 | 42,559 |
| O..... | 7,317 | 7,772 | 7,799 | 7,913 | 8,570 | 9,269 | 23,484 | 41,323 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | -4 | -68 | -507 | -600 | -47 | 6 | -1,175 | -1,216 |
| O..... | -4 | -49 | -384 | -736 | -437 | 10 | -1,168 | -1,596 |
| TOTAL, Energy supply research | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 1,958 | 2,167 | 2,308 | 2,255 | 2,245 | 2,199 | 6,730 | 11,174 |
| O..... | 2,204 | 2,188 | 2,335 | 2,292 | 2,265 | 2,214 | 6,814 | 11,293 |
| 2. POLICY | | | | | | | | |
| BA.... | 1,955 | 1,970 | 2,163 | 2,110 | 2,087 | 2,064 | 6,242 | 10,393 |
| O..... | 2,201 | 2,020 | 2,160 | 2,101 | 2,084 | 2,060 | 6,282 | 10,426 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | -3 | -197 | -145 | -145 | -158 | -136 | -487 | -781 |
| O..... | -3 | -168 | -174 | -190 | -181 | -153 | -533 | -867 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



ON & OFF BUDGET

CATEGORY: DISCRETIONARY PROGRAMS
Fast

| | 1986 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Park operations and land acquisition | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 1,293 | 1,343 | 1,369 | 1,395 | 1,419 | 1,442 | 4,107 | 6,968 |
| O..... | 1,347 | 1,305 | 1,340 | 1,361 | 1,377 | 1,394 | 4,006 | 6,777 |
| 2. POLICY | | | | | | | | |
| BA.... | 1,248 | 963 | 972 | 985 | 1,082 | 1,096 | 2,921 | 5,099 |
| O..... | 1,332 | 1,125 | 1,061 | 1,046 | 1,074 | 1,090 | 3,232 | 5,396 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | -45 | -380 | -397 | -410 | -338 | -345 | -1,186 | -1,869 |
| O..... | -15 | -180 | -279 | -315 | -303 | -304 | -774 | -1,381 |
| TOTAL, Civilian agency pay raise | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 0 | 1,374 | 3,290 | 5,398 | 7,583 | 9,757 | 10,062 | 27,402 |
| O..... | 0 | 1,319 | 3,213 | 5,314 | 7,496 | 9,670 | 9,846 | 27,012 |
| 2. POLICY | | | | | | | | |
| BA.... | 0 | 0 | 705 | 1,711 | 2,742 | 3,803 | 2,416 | 8,961 |
| O..... | 0 | 0 | 677 | 1,671 | 2,700 | 3,761 | 2,348 | 8,809 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | 0 | -1,374 | -2,585 | -3,687 | -4,841 | -5,954 | -7,646 | -18,441 |
| O..... | 0 | -1,319 | -2,536 | -3,643 | -4,796 | -5,909 | -7,498 | -18,203 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



(B - S)

ON & OFF BUDGET

CATEGORY: DISCRETIONARY PROGRAMS
Fast

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Other fast | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 45,989 | 44,641 | 45,050 | 45,962 | 46,465 | 48,610 | 135,653 | 230,728 |
| O..... | 50,088 | 47,660 | 47,502 | 48,507 | 49,083 | 51,097 | 143,670 | 243,849 |
| 2. POLICY | | | | | | | | |
| BA.... | 46,181 | 43,021 | 42,648 | 43,417 | 43,656 | 45,101 | 129,086 | 217,842 |
| O..... | 50,123 | 46,346 | 45,098 | 45,527 | 45,812 | 47,220 | 136,971 | 230,002 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | 192 | -1,620 | -2,402 | -2,546 | -2,809 | -3,509 | -6,568 | -12,886 |
| O..... | 35 | -1,314 | -2,405 | -2,980 | -3,272 | -3,877 | -6,699 | -13,847 |
| TOTAL, Fast | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 104,391 | 93,774 | 96,627 | 100,992 | 104,280 | 107,041 | 291,393 | 502,714 |
| O..... | 107,483 | 94,976 | 98,386 | 102,713 | 106,727 | 111,377 | 296,075 | 514,179 |
| 2. POLICY | | | | | | | | |
| BA.... | 103,907 | 81,965 | 81,693 | 84,157 | 86,359 | 89,085 | 247,815 | 423,259 |
| O..... | 106,993 | 85,994 | 83,497 | 84,790 | 87,009 | 90,760 | 254,281 | 432,050 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | -484 | -11,809 | -14,934 | -16,835 | -17,921 | -17,956 | -43,578 | -79,455 |
| O..... | -484 | -8,981 | -14,889 | -17,923 | -19,719 | -20,617 | -41,793 | -82,129 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



CATEGORY: DISCRETIONARY PROGRAMS
Loans

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Subsidized agricultural credit (ACIF) | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 7,267 | 4,579 | 2,454 | 2,936 | 6,251 | 3,552 | 9,969 | 19,771 |
| O..... | 2,784 | 3,136 | 2,161 | 2,480 | 2,903 | 2,349 | 7,776 | 13,029 |
| 2. POLICY | | | | | | | | |
| BA.... | 7,267 | 1,644 | 1,932 | 2,024 | 2,355 | 1,592 | 5,599 | 9,546 |
| O..... | 2,784 | 115 | -1,292 | -1,252 | -1,101 | -1,873 | -2,430 | -5,403 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | 0 | -2,935 | -522 | -912 | -3,896 | -1,960 | -4,369 | -10,225 |
| O..... | 0 | -3,021 | -3,453 | -3,732 | -4,004 | -4,222 | -10,206 | -18,432 |
| TOTAL, Rural housing (RHIF) | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 6,719 | 4,337 | 4,551 | 4,760 | 5,815 | 6,611 | 13,628 | 26,053 |
| O..... | 4,562 | 4,545 | 4,542 | 4,931 | 5,048 | 4,899 | 14,009 | 23,956 |
| 2. POLICY | | | | | | | | |
| BA.... | 6,719 | 2,306 | 2,545 | 2,624 | 2,619 | 2,532 | 7,474 | 12,625 |
| O..... | 4,562 | 2,311 | 1,420 | 1,394 | 1,070 | 655 | 5,124 | 6,850 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | 0 | -2,011 | -2,006 | -2,136 | -3,196 | -4,079 | -6,153 | -13,428 |
| O..... | 0 | -2,224 | -3,123 | -3,537 | -3,978 | -4,244 | -8,884 | -17,106 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



ON & OFF BUDGET

CATEGORY: DISCRETIONARY PROGRAMS
Loans

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Rural development (RDIF) | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 1,820 | 1,138 | 1,022 | 1,279 | 1,150 | 1,376 | 3,439 | 5,964 |
| O..... | 1,298 | 1,159 | 1,139 | 1,353 | 1,203 | 1,033 | 3,651 | 5,887 |
| 2. POLICY | | | | | | | | |
| BA.... | 1,820 | 975 | 787 | 913 | 770 | 909 | 2,676 | 4,356 |
| O..... | 1,298 | 1,108 | 906 | 988 | 764 | 542 | 3,003 | 4,308 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | 0 | -162 | -235 | -365 | -380 | -467 | -762 | -1,609 |
| O..... | 0 | -51 | -232 | -365 | -440 | -491 | -648 | -1,576 |
| TOTAL, Export-Import Bank | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 3,940 | 3,570 | 3,254 | 3,360 | 2,081 | 2,359 | 10,184 | 14,624 |
| O..... | 1,359 | 996 | 722 | 491 | 104 | 139 | 2,209 | 2,452 |
| 2. POLICY | | | | | | | | |
| BA.... | 3,940 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| O..... | 1,359 | 603 | -687 | -1,581 | -2,296 | -2,340 | -1,665 | -6,300 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | 0 | -3,570 | -3,254 | -3,360 | -2,081 | -2,359 | -10,184 | -14,624 |
| O..... | 0 | -393 | -1,409 | -2,072 | -2,400 | -2,478 | -3,874 | -8,752 |

CATEGORY: DISCRETIONARY PROGRAMS
Loans

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Small business assistance | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 1,109 | 1,193 | 1,267 | 1,338 | 1,396 | 1,447 | 3,798 | 6,641 |
| O..... | 989 | 1,046 | 1,102 | 1,157 | 1,210 | 1,245 | 3,305 | 5,760 |
| 2. POLICY | | | | | | | | |
| BA.... | 1,109 | 2,582 | 287 | 155 | 86 | 43 | 3,024 | 3,153 |
| O..... | 989 | 717 | 277 | 145 | 86 | 43 | 1,139 | 1,268 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | 0 | 1,389 | -980 | -1,183 | -1,310 | -1,404 | -774 | -3,488 |
| O..... | 0 | -329 | -825 | -1,012 | -1,124 | -1,202 | -2,166 | -4,492 |
| TOTAL, Rural electrification administration | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 3,579 | 2,889 | 2,577 | 2,448 | 2,414 | 2,045 | 7,915 | 12,374 |
| O..... | 3,379 | 2,679 | 2,327 | 2,188 | 2,144 | 1,745 | 7,194 | 11,084 |
| 2. POLICY | | | | | | | | |
| BA.... | 3,362 | 2,713 | 2,029 | 1,772 | 1,519 | 1,016 | 6,515 | 9,049 |
| O..... | 3,163 | 2,503 | 1,779 | 1,186 | 725 | 17 | 5,468 | 6,211 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | -216 | -176 | -548 | -676 | -895 | -1,029 | -1,400 | -3,324 |
| O..... | -216 | -176 | -548 | -1,003 | -1,419 | -1,728 | -1,726 | -4,873 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



ON & OFF BUDGET

CATEGORY: DISCRETIONARY PROGRAMS
Loans

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Community development | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 113 | 150 | 283 | 294 | 225 | 225 | 727 | 1,177 |
| O..... | 42 | 51 | 113 | 71 | -27 | -80 | 235 | 128 |
| 2. POLICY | | | | | | | | |
| BA.... | 113 | 116 | 137 | 69 | 0 | 0 | 322 | 322 |
| O..... | 42 | 25 | 23 | -59 | -104 | -95 | -11 | -210 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | 0 | -34 | -146 | -225 | -225 | -225 | -405 | -855 |
| O..... | 0 | -26 | -90 | -130 | -77 | -15 | -246 | -338 |
| TOTAL, Loans | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 24,545 | 17,835 | 15,408 | 18,415 | 19,332 | 17,614 | 49,658 | 86,605 |
| O..... | 14,413 | 13,602 | 12,106 | 12,671 | 12,586 | 11,331 | 38,379 | 82,295 |
| 2. POLICY | | | | | | | | |
| BA.... | 24,329 | 10,336 | 7,717 | 7,558 | 7,349 | 6,091 | 25,611 | 39,051 |
| O..... | 14,197 | 7,382 | 2,426 | 820 | -855 | -3,049 | 10,629 | 6,724 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | -216 | -7,499 | -7,691 | -8,857 | -11,983 | -11,523 | -24,047 | -47,554 |
| O..... | -216 | -6,220 | -9,680 | -11,850 | -13,441 | -14,380 | -27,750 | -55,571 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



(B - S),
ON & OFF BUDGET

CATEGORY: DISCRETIONARY PROGRAMS
Loans

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, DISCRETIONARY PROGRAMS | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 211,132 | 196,496 | 200,950 | 209,363 | 217,750 | 221,628 | 606,809 | 1,046,186 |
| O.... | 197,570 | 188,348 | 193,499 | 201,105 | 207,484 | 213,421 | 582,952 | 1,003,857 |
| 2. POLICY | | | | | | | | |
| BA.... | 209,693 | 155,163 | 155,084 | 159,863 | 162,404 | 164,534 | 470,110 | 797,048 |
| O.... | 196,044 | 167,130 | 157,260 | 155,799 | 157,157 | 158,880 | 480,189 | 796,226 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | -1,438 | -41,332 | -45,866 | -49,501 | -55,346 | -57,093 | -136,699 | -249,138 |
| O.... | -1,526 | -21,218 | -36,240 | -45,306 | -50,327 | -54,541 | -102,763 | -207,631 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



ON & OFF BUDGET

CATEGORY: DEFENSE
Defense

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, DOD | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 284,281 | 324,805 | 362,604 | 411,503 | 450,500 | 490,900 | 1,098,912 | 2,040,312 |
| O..... | 245,859 | 286,205 | 321,504 | 358,803 | 393,800 | 431,200 | 966,512 | 1,791,512 |
| 2. POLICY | | | | | | | | |
| BA.... | 284,735 | 313,705 | 354,004 | 401,603 | 438,800 | 477,700 | 1,069,312 | 1,985,812 |
| O..... | 246,305 | 277,505 | 312,304 | 348,603 | 382,300 | 418,300 | 938,412 | 1,739,012 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | 454 | -11,100 | -8,600 | -9,900 | -11,700 | -13,200 | -29,600 | -54,500 |
| O..... | 446 | -8,700 | -9,200 | -10,200 | -11,500 | -12,900 | -28,100 | -52,500 |
| TOTAL, Atomic energy and other | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 7,829 | 8,837 | 9,310 | 9,915 | 10,134 | 10,585 | 28,062 | 48,782 |
| O..... | 7,381 | 8,372 | 8,861 | 9,681 | 10,001 | 10,426 | 26,913 | 47,340 |
| 2. POLICY | | | | | | | | |
| BA.... | 7,818 | 8,500 | 9,255 | 9,860 | 10,064 | 10,395 | 27,616 | 48,075 |
| O..... | 7,525 | 8,164 | 8,856 | 9,775 | 9,963 | 10,260 | 26,794 | 47,018 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | -11 | -337 | -54 | -56 | -70 | -190 | -446 | -707 |
| O..... | 143 | -208 | -5 | 94 | -38 | -166 | -119 | -323 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



(B - S)

ON & OFF BUDGET

CATEGORY: DEFENSE
Defense

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Defense | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 292,110 | 333,642 | 371,914 | 421,418 | 460,634 | 501,485 | 1,126,974 | 2,089,094 |
| O..... | 253,240 | 294,577 | 330,365 | 368,484 | 403,801 | 441,626 | 993,425 | 1,838,852 |
| 2. POLICY | | | | | | | | |
| BA.... | 292,553 | 322,205 | 363,259 | 411,463 | 448,864 | 488,095 | 1,096,927 | 2,033,887 |
| O..... | 253,830 | 285,669 | 321,160 | 358,378 | 392,263 | 428,560 | 965,206 | 1,786,029 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | 443 | -11,437 | -8,654 | -9,956 | -11,770 | -13,390 | -30,046 | -55,207 |
| O..... | 589 | -8,908 | -9,205 | -10,106 | -11,538 | -13,066 | -28,219 | -52,823 |
| TOTAL, DEFENSE | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 292,110 | 333,642 | 371,914 | 421,418 | 460,634 | 501,485 | 1,126,974 | 2,089,094 |
| O..... | 253,240 | 294,577 | 330,365 | 368,484 | 403,801 | 441,626 | 993,425 | 1,838,852 |
| 2. POLICY | | | | | | | | |
| BA.... | 292,553 | 322,205 | 363,259 | 411,463 | 448,864 | 488,095 | 1,096,927 | 2,033,887 |
| O..... | 253,830 | 285,669 | 321,160 | 358,378 | 392,263 | 428,560 | 965,206 | 1,786,029 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | 443 | -11,437 | -8,654 | -9,956 | -11,770 | -13,390 | -30,046 | -55,207 |
| O..... | 589 | -8,908 | -9,205 | -10,106 | -11,538 | -13,066 | -28,219 | -52,823 |

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OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions

(6 - S)

ON & OFF BUDGET

CATEGORY: DEBT FINANCING
Debt Financing

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Debt Financing | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 154,848 | 172,770 | 190,781 | 201,799 | 195,248 | 192,747 | 565,350 | 953,345 |
| O..... | 154,848 | 172,770 | 190,781 | 201,799 | 195,248 | 192,747 | 565,350 | 953,345 |
| 2. POLICY | | | | | | | | |
| BA.... | 154,740 | 169,656 | 180,838 | 184,673 | 172,559 | 162,541 | 535,167 | 870,267 |
| O..... | 154,740 | 169,656 | 180,838 | 184,673 | 172,559 | 162,541 | 535,167 | 870,267 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | -107 | -3,114 | -9,943 | -17,126 | -22,689 | -30,206 | -30,183 | -83,078 |
| O..... | -107 | -3,114 | -9,943 | -17,126 | -22,689 | -30,206 | -30,183 | -83,078 |
| TOTAL, Debt Financing | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA..... | 154,848 | 172,770 | 190,781 | 201,799 | 195,248 | 192,747 | 565,350 | 953,345 |
| O..... | 154,848 | 172,770 | 190,781 | 201,799 | 195,248 | 192,747 | 565,350 | 953,345 |
| 2. POLICY | | | | | | | | |
| BA.... | 154,740 | 169,656 | 180,838 | 184,673 | 172,559 | 162,541 | 535,167 | 870,267 |
| O..... | 154,740 | 169,656 | 180,838 | 184,673 | 172,559 | 162,541 | 535,167 | 870,267 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | -107 | -3,114 | -9,943 | -17,126 | -22,689 | -30,206 | -30,183 | -83,078 |
| O..... | -107 | -3,114 | -9,943 | -17,126 | -22,689 | -30,206 | -30,183 | -83,078 |

## Reconsideration of Defense and Non-defense Spending Decisions

Question: The President notes in his Budget Message that

> "Domestic spending, which previously grew faster than any other major part of the budget (nearly four-fold in real terms between 1960 and 1980), will have been virtually frozen from 1981 to 1985."

By my measure, the amount of non-defense domestic, discretionary budget authority has declined from $97.3 billion in 1980 to $65.0 billion in 1985, or 33 percent in 1972 constant dollars.

Given this reduction, why does the heaviest burden of proof for continued spending lie on the non-defense front?

Answer: The defense budget is driven by our need for defense capabilities, which in turn is driven by external events -- in particular, the Soviet arms build-up. We have an obligation to see that our defense dollars are used as economically as possible, that our defense requirements are met at the minimum possible cost. Beyond that, the only secure way to constrain the overall size of the defense budget is through arms control agreements with the Soviets.

Given this fact, the clear instruction from the American people that taxes must not be raised, and the unprecedented structural deficits that must be reduced if we are to maintain a healthy financial system and continued non-inflationary economic growth, there is no choice. Domestic spending must be reduced. This is not a matter of putting a burden of proof on domestic programs. Indeed, some of them -- e.g., social security, unemployment insurance, and means-tested safety net programs -- have been protected. The Administration reviewed the remaining programs carefully and made fundamental choices about what could be afforded and what could not be. The resulting proposed reductions were based on three principles of choice:

- Purely local economic development subsidies and fiscal aid are no longer affordable and produce few net national benefits.

- o Major benefit programs that have been expanded well beyond their original purposes must be pared back and reformed.

- o The time has come to curtail unjustified business, commercial, and regional subsidies.

Non-Defense Spending Increases

Question: In your budget, in Function 920, Allowances, you have included an amount of $1.5 billion in budget authority and $1.125 billion in outlays in FY 85 for "allowances for contingencies".

What are these contingencies?

(If no specifics are forthcoming)
How, then, have you determined an outlay rate?

Answer: The allowance for contingencies is an estimate included within the President's budget for items likely to require funding but for which funds are not requested in the budget (either in regular, supplemental, or later transmittal schedules) because the circumstances requiring funding have not yet materialized. The contingency allowance referred to in the question is for potential reestimates and minor programmatic changes.

The outlay rate associated with the fiscal year 1985 allowance cited is generally consistent with the spendout rates assumed for the allowance for contingencies in the past.

TREATMENT OF 5 PERCENT PAY REDUCTION

Question: You submitted a budget for each account as if a 5 percent salary reduction for Fiscal Year 1986 had already been enacted into law.

How much does this committee need to add to your FY 1986 budget if a 5 percent salary reduction is not enacted?

Answer: If salaries are not reduced by 5 percent, we will expect agencies to absorb the maximum amount possible of the increased pay costs, consistent with budget authority

availability and program requirements. This is the policy that Administrations and the Congress have followed for years. Hence, no precise estimate can be made of the effect of not enacting a 5 percent pay reduction. The potential cost exposure, however, is between zero and $3.5 billion for both defense and nondefense agencies in FY 86, depending on the extent of absorption.

## Apples and Oranges

Question: You have caused my bean counters a great deal of heartburn by mixing apples and oranges in your budget submission. In your Fiscal Year 1986 historical tables you mix on-budget and "off-budget" items and you add "imputed accruals for military retirement benefits" to all your numbers.

Will you provide the Committee with a table of historical spending and, especially defense spending, on the old basis?

Answer: Our historical data base distinguishes between the amounts that are off-budget under current law and those that are on-budget under current law. Attached is page 2 of table 1.1 Historical Tables, Budget of the United States Government, 1986, that provides these data on a summary basis.

Additional details are available in other tables in that book. For example, table 3.3 shows total budget outlays by function and subfunction, and separately shows the amounts that are on-budget under current law and those that are off-budget under current law.

A table showing the national defense function totals as currently constituted (using imputed accruals) to the defense totals on the old basis is also attached. Since the law shifting military retired pay from DOD military and charging accruals to DOD military was effective as of fiscal year 1985, this table does not extend beyond 1984.

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



ON & OFF BUDGET

CATEGORY: DEBT FINANCING
Debt financing

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, DEBT FINANCING | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA | 154,848 | 172,770 | 190,781 | 201,799 | 195,248 | 192,747 | 565,350 | 953,345 |
| O | 154,848 | 172,770 | 190,781 | 201,799 | 195,248 | 192,747 | 565,350 | 953,345 |
| 2. POLICY | | | | | | | | |
| BA | 154,740 | 169,656 | 180,838 | 184,673 | 172,559 | 162,541 | 535,167 | 870,267 |
| O | 154,740 | 169,656 | 180,838 | 184,673 | 172,559 | 162,541 | 535,167 | 870,267 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA | -107 | -3,114 | -9,943 | -17,126 | -22,689 | -30,206 | -30,183 | -83,078 |
| O | -107 | -3,114 | -9,943 | -17,126 | -22,689 | -30,206 | -30,183 | -83,078 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



CATEGORY: OFFSETTING RECEIPTS
Offsetting receipts

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, Offsetting receipts | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | -63,103 | -69,339 | -72,936 | -71,414 | -74,555 | -78,040 | -213,689 | -366,284 |
| O..... | -63,103 | -69,339 | -72,936 | -71,414 | -74,555 | -78,040 | -213,689 | -366,284 |
| 2. POLICY | | | | | | | | |
| BA.... | -63,224 | -72,965 | -76,072 | -74,273 | -77,226 | -79,899 | -223,310 | -380,435 |
| O..... | -63,224 | -72,965 | -76,072 | -74,273 | -77,226 | -79,899 | -223,310 | -380,435 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | -121 | -3,626 | -3,135 | -2,859 | -2,672 | -1,859 | -9,621 | -14,152 |
| O..... | -121 | -3,626 | -3,135 | -2,859 | -2,672 | -1,859 | -9,621 | -14,152 |
| TOTAL, Offsetting receipts | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | -63,103 | -69,339 | -72,936 | -71,414 | -74,555 | -78,040 | -213,689 | -366,284 |
| O..... | -63,103 | -69,339 | -72,936 | -71,414 | -74,555 | -78,040 | -213,689 | -366,284 |
| 2. POLICY | | | | | | | | |
| BA.... | -63,224 | -72,965 | -76,072 | -74,273 | -77,226 | -79,899 | -223,310 | -380,435 |
| O..... | -63,224 | -72,965 | -76,072 | -74,273 | -77,226 | -79,899 | -223,310 | -380,435 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | -121 | -3,626 | -3,135 | -2,859 | -2,672 | -1,859 | -9,621 | -14,152 |
| O..... | -121 | -3,626 | -3,135 | -2,859 | -2,672 | -1,859 | -9,621 | -14,152 |

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OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



(8 - S)

ON & OFF BUDGET

CATEGORY: OFFSETTING RECEIPTS
Offsetting receipts.

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| TOTAL, OFFSETTING RECEIPTS | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | -63,103 | -69,339 | -72,936 | -71,414 | -74,555 | -78,040 | -213,689 | -366,284 |
| O..... | -63,103 | -69,339 | -72,936 | -71,414 | -74,555 | -78,040 | -213,689 | -366,284 |
| 2. POLICY | | | | | | | | |
| BA.... | -63,224 | -72,965 | -76,072 | -74,273 | -77,226 | -79,899 | -223,310 | -380,435 |
| O..... | -63,224 | -72,965 | -76,072 | -74,273 | -77,226 | -79,899 | -223,310 | -380,435 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | -121 | -3,626 | -3,135 | -2,859 | -2,672 | -1,859 | -9,621 | -14,152 |
| O..... | -121 | -3,626 | -3,135 | -2,859 | -2,672 | -1,859 | -9,621 | -14,152 |

OMB CENTRAL BUDGET MANAGEMENT SYSTEM/PBBCAS
1986 FALL ADJUSTED CURRENT SERVICES
SUMMARY
Nominal Dollars in Millions



ON & OFF BUDGET

CATEGORY: REPORT TOTAL

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | TOTAL 1986-88 | TOTAL 1986-90 |
|---|---|---|---|---|---|---|---|---|
| REPORT TOTAL | | | | | | | | |
| 1. CURRENT SERVICES | | | | | | | | |
| BA.... | 1,065,811 | 1,130,190 | 1,227,598 | 1,353,126 | 1,435,695 | 1,524,124 | 3,710,914 | 6,670,733 |
| O..... | 960,439 | 1,024,519 | 1,109,288 | 1,200,079 | 1,262,779 | 1,332,770 | 3,333,885 | 5,929,434 |
| 2. POLICY | | | | | | | | |
| BA.... | 1,064,870 | 1,059,983 | 1,143,011 | 1,252,992 | 1,317,475 | 1,391,776 | 3,455,986 | 6,165,236 |
| O..... | 959,085 | 973,725 | 1,026,625 | 1,094,761 | 1,137,390 | 1,190,030 | 3,095,111 | 5,422,532 |
| 3. POLICY - CURRENT SERVICES (2 - 1) | | | | | | | | |
| BA.... | -941 | -70,208 | -84,587 | -100,134 | -118,220 | -132,348 | -254,928 | -505,497 |
| O..... | -1,354 | -50,794 | -82,662 | -105,318 | -125,389 | -142,740 | -238,774 | -506,902 |

BRIDGE FROM NATIONAL DEFENSE OUTLAYS INCLUDING IMPUTED ACCRUALS
TO NATIONAL DEFENSE OUTLAYS EXCLUDING ACCRUALS
(fiscal years; in millions of dollars)

| Year | Including accruals (current data base) 1/ | Subtract Imputed Accruals | Add Cash retirement benefits | Excluding accruals (old data base) 2/ |
|---|---|---|---|---|
| 1984..... | 227,413 | 16,503 | 16,471 | 227,381 |
| 1983..... | 209,902 | 15,362 | 15,945 | 210,484 |
| 1982..... | 185,309 | 12,829 | 14,938 | 187,417 |
| 1981..... | 157,513 | 11,532 | 13,729 | 159,710 |
| 1980..... | 133,995 | 10,055 | 11,920 | 135,860 |
| 1979..... | 116,342 | 8,938 | 10,279 | 117,683 |
| 1978..... | 104,495 | 8,478 | 9,171 | 105,189 |
| 1977..... | 97,241 | 7,957 | 8,216 | 97,500 |
| TQ..... | 22,269 | 1,910 | 1,947 | 22,306 |
| 1976..... | 89,619 | 7,482 | 7,296 | 89,433 |
| 1975..... | 86,509 | 7,194 | 6,242 | 85,556 |
| 1974..... | 79,347 | 6,681 | 5,128 | 77,794 |
| 1973..... | 76,681 | 6,527 | 4,390 | 74,544 |
| 1972..... | 79,174 | 6,535 | 3,885 | 76,524 |
| 1971..... | 78,872 | 6,446 | 3,386 | 75,812 |

1/ Excludes 2 million of outlays in 1984 and 1 million in 1983 that are off-budget under current law.
2/ Data are available for years back to 1940.

## Line-Item Veto

Question: If the line-item veto is enacted into law, how can I turn down any member's requests -- no matter how absurd or parochial -- if he or she says, "Well, the President can just veto it later?"

Will you be asking me to take care of Senator X's items in some bill (with the understanding it will be vetoed later) in order to assure that Senator's vote on some other, unrelated matter?

Answer: No. I do not believe that the existence of line-item veto authority would lead to the result implied by the question. Negotiations on the specifics of legislation are an on-going part of the appropriate interaction of the Executive Branch with the Legislature and would continue to be so. My expectation is that requests of the sort described would be fewer if line-item veto authority existed.

The President believes that enactment of a line-item veto provision is essential to his efforts to curtail the growth of government spending.

Question: Do you seriously believe that Congress would pass a foreign aid bill if the Administration could get its military aid package, and then strip out economic assistance?

Answer: Two points are relevant to this question:

First, as the President stated in his State of the Union address this year and on other occasions, he supports a line-item veto provision that would establish for the President "the authority used responsibly by 43 governors to veto individual items in appropriations bills." He supports enactment of a bill, like Senator Mattingly's, providing a 2-year trial of the line-item veto.

Second, the President accords great importance to obtaining enactment of authorizations and appropriations that allow adequate funds to carry out U.S. foreign policy and national security goals. As is

unmistakeable in the President's budget request, attainment of those goals requires appropriations for both military and economic assistance programs. It is highly unlikely that the President would "strip out" economic assistance that he has requested.

Question: In 1983, I made the case in conference that if a speed-up in General Revenue Sharing payments were made, you would recommend to the President that he veto the Jobs bill.

In 1984, I argued on behalf of the administration despite my own interests, that all water projects should be stripped from the Continuing Resolution.

These were, in effect, line-item vetoes.

Since the Administration already has a demonstrated de facto line-item veto, why do you pretend to need a formal line-item veto?

Answer: The examples cited illustrate the appropriate interaction of the Executive Branch with the Legislature in response to proposed increases in appropriations that are sufficiently large or otherwise objectionable to warrant vetoing an entire bill. The line-item veto authority would make it possible for the President to delete, subject to congressional override, numerous small increases or less objectionable provisions. These increases or provisions do not justify vetoing important bills, but, over time and taken together, they add significantly to the budget or to the cost of managing the Federal government.

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## Questions Submitted by Senator Proxmire

### Great Lakes Water Quality Program

Question: The EPA reprogrammed about $500,000 to the Resource Conservation and Recovery Act program from the Great Lakes Quality program. The Canadian Government is concerned that this will leave the Great Lakes program with insufficient funds to carry out the requirements of the Great Lakes Water Quality Agreement.

Would you give me a breakdown of how you recommend that EPA spend Great Lakes funds and whether you think your cuts will interfere with achievement of the treaty goals and why.

Answer: The $500,000 that EPA reprogrammed came from a $3 million 1985 Congressional addition to the President's budget request. Since the President's 1985 Budget included adequate funds to carry out the requirements of the Great Lakes Water Quality Agreement, the reprogramming will have no impact on EPA's ability to conduct appropriate analyses. It will merely reduce the amount of the add-on. Further, $1.3 million in unobligated funds from prior year Congressional additions will be available, if needed, in 1985 for any purpose under the Agreement.

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## Questions Submitted by Senator Leahy

### Cost of Compliance with Executive Order No. 12291

Question: Please provide an estimate of the costs incurred by each agency on an annual basis to comply with Executive Order No. 12291.

Answer: The purposes of Executive Order No. 12291 are to control the growth of Federal regulation and to ensure that individual regulations are well-reasoned, economically sound, and coordinated with the policies of other agencies. As required by the Order, new regulations must be based on adequate information concerning the need for and consequences of the proposed action, and regulations must not be issued unless the potential benefits to society outweigh the potential costs to society. To ensure compliance with these principles, the President ordered that all proposed and final regulations be submitted for OMB review before publication.

The incremental cost of agency compliance with Executive Order No. 12291 is minimal. Properly managed agencies have been trying to adhere to these regulatory principles for some time. Agencies have likewise conducted indepth analysis of complex regulatory proposals for some time. We have not

attempted to measure the additional costs, if any, that this Order required in comparison to what the agency was doing previously. In other words, even for the most burdensome rules, the increased costs of Executive Order No. 12291 may vary greatly depending upon the baseline of analysis effort assumed before the costs of compliance with the Order. In some cases, the only cost of Executive Order No. 12291 was the cost of transmitting to OMB a copy of a draft regulation ready to be sent to the Federal Register.

Cost of Compliance with Executive Orders No. 12291 and 12498

Question: Please provide an estimate of the costs that will be incurred in FY 1985 and FY 1986 to comply with Executive Orders No. 12291 and 12498.

Answer: Executive order No. 12498 builds upon the principles and procedures of Executive Order No. 12291. In effect, Executive Order No. 12498 moves the OMB review conducted under Executive Order No. 12291 to an earlier point in the agency's rulemaking process.

This year, in accord with OMB Bulletin No. 85-9, the heads of 17 regulatory departments and agencies are sending to OMB a statement of regulatory policies and goals, and a summary description of significant regulatory activities, they intend to pursue during the coming year (April 1985-March 1986). We are now reviewing these draft agency regulatory programs for consistency with Administration regulatory policy and the plans of other agencies. We plan to publish the results of this effort, the Administration's Regulatory Program for 1985, in May.

Executive Order No. 12498 permits agency heads, on an annual basis, to set the agency's regulatory priorities, and to direct agency resources to the most serious regulatory issues. OMB will be able to reduce delay and last minute questions about significant rules under Executive Order No. 12291. The publication of the Administration's Regulatory Program for 1985 will give the Administration the opportunity to state its regulatory program in a

cohesive way, and to present it to the public and Congress as early as possible.

As with Executive Order No. 12291, we have not asked for an estimate of the incremental costs--if any--for agency compliance with Executive Order No. 12498, nor have any additional funds been requested for such compliance. Furthermore, because work on Executive Order No. 12498 will offset costs of Executive Order No. 12291, the incremental cost of Executive Order No. 12498 will not be large. Agency regulatory policy statements and summaries are based on the prerulemaking activities they have already analyzed and initiated. We do not yet know the cost of publishing the 1985 Regulatory Program; one very rough estimate is $50,000. Many of these copies will be transmitted to the Congress because we believe that the members will be interested in it.

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## COUNCIL OF ECONOMIC ADVISORS

### QUESTIONS SUBMITTED BY SENATOR HATFIELD

CONSEQUENCES OF ECONOMIC STALL

Q. On paper, nearly all of the economic forecasts presented so far are "sparkling," to use CEA's expression, However, only Rudy Penner at CBO has cautioned us on the consequences if strong growth and economic recovery stall. Specifically, he stated deficits could increase to $425 billion or 8.7 percent of GNP by the end of the decade. Do you share the belief that the consequences might be this severe? What do you consider to be the sensitivity of your assumptions?

A. Future Federal deficits would be higher than that projected by the Administration under either of the following two conditions:

- Congress approves a FY 1986 budget that is larger than that proposed by the President, or

- Economic conditions are not as favorable as that projected by the Administration.

It is difficult to understand, however, how the deficits could be as high as $425 billion in the absence of rapid spending growth or a severe recession.

Given the Administration's economic assumptions, the President's FY 1986 budget would reduce the projected deficit in FY 1990 from $224 billion to $82 billion (p. 2-2 of the Budget). The deficit

would be larger than this by the amount that the budget approved by Congress exceeds that proposed by the President.

Given the FY 1986 budget proposed by the President, an increase in interest rates by one percentage point beginning in mid-1985 would increase the FY 1990 deficit by about $17 billion. A reduction in the growth of real GNP by one percentage point beginning in 1986 would increase the FY 1990 deficit by about $73 billion. (These and other estimates of the sensitivity of the budget to economic assumptions are presented in pps. 3-20 to 3-23 of the Budget.)

The possible combination of the current service budget, one percentage point higher interest rates, and one percentage point lower real growth rates would lead to a FY 1990 budget deficit of about $314 billion. Most of the difference between this possible deficit and that projected by the Administration is due to the budget cuts proposed by the President. Moreover, the economic conditions leading to a smaller deficit are also more likely to be achieved by approval of the proposed FY 1986 budget than by a budget with higher spending, taxation, or borrowing.

## TAXES NEEDED TO SUPPLEMENT GROWTH

Q. Even under the assumption that economic growth will continue at 4.5 to 5.0 percent, will growth be sufficient to support continued spending rates, pay interest on the debt AND retire the deficit or is it just a matter of time that growth will fail to sustain the economy and additional tax increases, or tax cut deferrals will have to be implemented? What is your estimate as to when economic growth must be supported with revenue enhancements? Early fiscal 1985, late fiscal 1985, or not until fiscal 1986?

A. Economic growth within the plausible range will <u>not</u> be sufficient to reduce the Federal deficit to an acceptable level. The combination of sustained economic growth <u>plus</u> spending restraint, however, can be sufficient. Given the Administration's economic assumptions, the proposed FY 1986 budget is sufficient to stabilize the ratio of the outstanding Federal debt to GNP by FY 1988; a lower growth rate or higher budget would lead to a continued growth of the debt/GNP ratio and the interest payments/GNP ratio. The proposed FY 1986 budget would not eliminate the problems associated with the deficit, but it would probably be sufficient to avoid a progressive deterioration of these problems.

There is no way for an economist to estimate when a tax increase would be necessary. A vote to increase taxes is a <u>political</u> decision about the desirable size of the Federal budget. If the American people prefer a Federal budget equal to 24 percent of the GNP (the 1984 share), we need a large tax increase soon. On the other hand, if they prefer a Federal budget equal to 20 percent of the GNP, no tax increase is necessary now or in the future.

Sooner or later, federal spending must be financed by federal taxes. President Reagan's judgement is that the value of many Federal programs is less than the cost of these programs to the economy; in other words, most Americans would prefer to reduce or eliminate these programs rather than to increase taxes by an amount sufficient to

finance these programs. I strongly support that judgement. The 1984 election suggests that most of the American electorate also supports that judgement. Congress owes the American people a serious sustained effort to reduce the budget by an amount sufficient to avoid a tax increase.

## FOREIGN INVESTMENT

Q. Comparatively high real interest rates in the United States, accompanied by a virtual cessation of American money going abroad resulted in over $120 billion in foreign capital coming into this country last year. This influx of foreign capital has heavily subsidized private U.S. savings in offsetting the U.S. deficit without crowding out private investment. But how long can we count on this influx of foreign capital? Is it not dangerous for future administrations to have this foreign debt hanging over our heads? Finally, is not solving the problem a paradox between increasing our trade abroad (by devaluing the dollar's strength) and triggering high domestic inflation?

A. Capital inflows from abroad (about $103 billion in 1984) have helped sustain a level of investment in the United States that is higher than the level of private saving, net of government borrowing. Net capital inflows of some amount are likely to continue as long as the real post-tax rate of return in the United States is higher than in other industrial nations.

The current account deficit is now too high to be sustained, but the economic effects of different means to reduce this deficit are very different. The best ways to reduce this deficit are to reduce government borrowing, to reduce the tax bias against saving, and to encourage economic growth abroad. The worst effective way to reduce the current account deficit is to increase the tax rate on the return to investment in the United States. Actions specific to trade, such as the proposed import surcharge, would have very undesirable consequences but have no significant effect on the current account deficit.

Actions that would reduce the real exchange value of the dollar would reduce the trade and current account deficits but would increase U.S. inflation. There is no apparent way out of this trade-off. It will continue to be important to reduce the primary sources of inflation, by restraining money growth and by maintaining the growth of domestic output.

## CEA ANNUAL REPORT AND THE LINE-ITEM VETO

Q. I read with interest your statement in favor of line-item veto authority in your annual report. (See attached sheet). Your statements of fact, however, seem to belie conclusions.

For example, you note that per capita spending is somewhat higher in States where the Governor has the authority for a line-item veto and you state "Approval of a line-item veto may not have a substantial effect on total Federal expenditure."

You note that the expected benefit woyld come primarily from shifting priorities from those of Congress to those of one person, the President.

Is that much of a fiscal policy argument in favor of the line-item veto authority?

A. The near-term case for a line-item veto is to give President Reagan an additional instrument to help resolve the serious problem of excessive growth of Federal spending.

The long-term case for a line-item veto is to shift the composition of Federal spending toward programs with national benefits and away from programs for which the benefits are primarily local or sectoral. The question suggests that this would shift priorities "from those of Congress to those of one person, the President". My perspective is that it is better to view this issue in terms of the incentives faced by Members of Congress and the President in representing the priorities of the American people. The effect of a line-item veto would be to better represent our shared national priorities rather than our regional priorities that, in most cases, are better handled by State and local governments.

Congress has long recognized the importance of a line-item veto by granting such authority to the governors of the Trust Territories and the Commonwealth of Puerto Rico and to the Mayor of the District of Columbia. The strongest line-item veto authority in the United States is in the State of Alsska, an authority approved by Congress when Alaska was a territory. At best, the position of Congress on this issue has not been consistent.

President Reagan has endorsed legislation to provide the authority for a line-item veto for a limited period. If this experiment is perceived to be successful, it should be reenforced by an amendment to the Constitution. I strongly support the Mattingly bill that would provide the authority for this experiment.

Excerpt: page 96, Annual Report of the Council of Economic Advisers

Approval of a line-item veto may not have a substantial effect on total Federal expenditure. The experience of the States indicates that per capita spending is somewhat higher in States where the Governor has the authority for a line-item veto, even when corrected for the major conditions that affect the distribution of spending among States. In addition, less than one-half of the Federal budget would be subject to a line-item veto, and most of that would be for defense. A President committed to Federal spending restraint, however, could use this as an effective tool to reduce total spending.

Another argument for a line-item veto is to change the composition of Federal expenditure—from activities preferred by the Congress to activities preferred by the President. A Member of Congress is elected from a specific district or State—the President is elected by the Nation. As a consequence, a Member of Congress has stronger preferences for activities that benefit his or her regional constituency, and the President has stronger preferences for activities that benefit the Nation. The expected result of granting approval for a line-item veto would be an increase in the relative expenditures with national benefits and a reduction in the relative expenditures for pork barrel projects. That should be a sufficient basis for early approval of presidential authority for a line-item veto.

SUBCOMMITTEE RECESS

Chairman HATFIELD. At 2 p.m. tomorrow we will hear from Dr. Shultz and Dr. Weidenbaum and Dr. Penner in a special oversight hearing on the budget, at the request of Senator Abdnor, in the morning. Next Wednesday Mrs. Carol Stockman of St. Joseph, MI, will testify on Federal budgeting and child disobedience. [Laughter.]

[Whereupon, at 4:43 p.m., Tuesday, February 19, the committee was recessed, to reconvene at the call of the Chair.]

# ECONOMIC OVERVIEW FOR FISCAL YEAR 1986

WEDNESDAY, FEBRUARY 27, 1985

U.S. SENATE,
COMMITTEE ON APPROPRIATIONS,
*Washington, D.C.*

The committee met at 2:05 p.m., in room SD-192, Dirksen Senate Office Building, Hon. Mark Hatfield (chairman) presiding.

Present: Senators Hatfield, Weicker, Abdnor, Kasten, Chiles, Sasser, Bumpers, and Lautenberg.

## CONGRESSIONAL BUDGET OFFICE

### STATEMENT OF RUDOLPH G. PENNER, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

#### HEARING PROCEDURE

Chairman HATFIELD. The hearing will please come to order.

I am pleased to have before the committee today the expert testimony of a number of distinguished economists who have been longtime observers on the Federal budget process.

We will begin by hearing from Dr. Rudolph G. Penner, Director of the Congressional Budget Office, who will present to the committee his report on the analysis an reestimates of the President's fiscal year 1986 budget request. Following a period for questioning, Dr. Penner—I think probably we will change that procedure. I think we will proceed to hear then from Dr. Weidenbaum. Unless there is a time constraint you have, Dr. Penner, I would like to have all the formal testimony and then we can ask the questions of the panel.

I understand Dr. Schultze is not here and will not be able to be here until a little later.

We will hear from Dr. Murray Weidenbaum, director of the Center for the Study of American Business at Washington University in St. Louis and Dr. Charles Schultze of the University of Maryland and the Brookings Institute.

#### RECOGNITION OF BUDGET DOCUMENTS

First of all, before you begin, Dr. Penner, I want to take this public occasion, since it is the first I have had, to commend the CBO for its superb analysis of the issues before us as set forth in its major studies: "The Economic Budget Outlook, Fiscal Years 1986-1990"; "Reducing the Deficit Spending and Revenue Options"; and number three, an

"Analysis of the President's Budgetary Proposals for FY 1986." As I say, they are superb presentations, demonstrating great scholarship, excellent research, brilliant analysis. I am delighted to commend you on that.

RECOGNITION OF SENATOR LAUTENBERG

This being sort of a premiere occasion on the opportunity to welcome to our committee our new member, Senator Lautenberg of New Jersey, I want to also have the record show that this is his first session with us; and, Senator, knowing you as a colleague in the Senate, we welcome you with open arms. You will make a great addition to our committee.

Senator LAUTENBERG. Thank you, Mr. Chairman. I am glad to be here. I have some opening remarks which I will insert for the record.

Chairman HATFIELD. So ordered.

[The statement follows:]

OPENING STATEMENT OF FRANK R. LAUTENBERG

U.S. SENATOR FROM NEW JERSEY

Thank you, Mr. Chairman. First, I want to say how pleased I am to be joining the Appropriations Committee. I look forward to working with you, Mr. Chairman, Senator Stennis, and the other members of the committee. We face some very tough challenges. Getting the budget under control without undermining those programs that are essential to national progress will not be easy. It will take cooperation, mutual support, and leadership. I know that you and Senator Stennis will provide the leadership. I want you to know that you will have my cooperation and support.

I will be interested to hear the views and recommendations of our distinguished witnesses today. They all agree—as do most creditable economists—that policies which produce $180–$200–$300 billion deficits cannot be continued indefinitely without serious long term damage to our economy. We are already a credit card nation, living on massive infusions of foreign capital. The dollar continues to climb and our trade position weakens. No one—with the possible exception of the President—thinks we can stay on this path forever. The real question is: How long do we have? My concern is that the dangers inherent in current policy are so insidious, and so invisible to most Americans, that little will be done before it is too late.

CBO ANALYSIS OF BUDGET PROPOSAL

Chairman HATFIELD. Dr. Penner, you may proceed.

Dr. PENNER. Thank you very much, Mr. Chairman, for your kind words. I am pleased to present this afternoon CBO's analysis of the President's budgetary proposals for fiscal year 1986. Copies of our analysis, which was prepared at the request of this committee, have been distributed to members and my statement will summarize its findings.

The administration's budget proposals this year are very different from those of a year ago. The President's 1985 budget did not recommend major policy changes in terms of either revenues or expenditures. This year, the President proposes a major assault on the projected budget deficits by reducing the growth in government spending. CBO estimates that approval of the administration's proposals would hold the growth in total outlays to 2.5 percent in 1986, compared with 13 percent in 1985. Only minor changes are proposed for Federal taxes, and total revenues next year are projected to grow by over 7 percent. As a

consequence, the total deficit would decline from an estimated $215 billion in the current year to $186 billion in 1986, or roughly the same level as for 1984.

The budget outlook after 1986 depends critically on what assumptions are made about the performance of the economy. Our analysis of the President's budget is made in terms of changes from the CBO baseline budget projections for the 1986–90 period. These projections were presented in detail a few weeks ago in the first volume of our annual report to the Budget Committees. They provide a basis for evaluating the "static" or "direct" budgetary impacts of proposed changes in spending and tax provisions—that is, the impacts measured before any consideration is given to changes in the economy that might be caused by the policy changes, and to the impacts such changes in the economy might in turn have on the budget.

## GROWTH OF ECONOMIC ASSUMPTIONS, REVENUES, AND OUTLAYS

Using CBO's economic assumptions, revenues and outlays under the administration's proposals would both grow at about the same rate in 1987–90, and the deficit would remain at about $186 billion throughout the period. Under the administration's economic assumptions, however, growth in revenues would be greater than growth in expenditures and the deficit would continue to decline steadily, falling below $100 billion in 1990.

## BASELINE BUDGET PROJECTS

CBO's baseline budget projections assume, for the most part, no changes in current laws governing taxes or entitlement spending. For nondefense spending that is discretionary and subject to annual appropriations, the baseline projections generally assume that the 1985 appropriation levels will be increased to keep pace with inflation. For defense spending, an extrapolation of the 1985 congressional budget resolution is used as the best approximation of current policy.

Table 1 shows the latest CBO baseline budget projections. The outlay and deficit projections are slight upward revisions of those published earlier this month and reflect additional information about spending patterns gleaned from the President's budget.

## GROSS NATIONAL PRODUCT

In relation to Gross National Product, baseline deficits are roughly stable—at about 5.4 percent of GNP. In dollar terms, however, the baseline deficit rises from $220 billion in 1986 to $302 billion by 1990. With deficits of this magnitude, Federal debt held by the public would more than double over the next 6 years.

## DEFENSE AND NONDEFENSE SPENDING

The administration's 1986 budget continues the current trends toward higher defense and lower nondefense spending. The proposed reductions in nondefense outlays are similar in size to those requested by President Reagan in 1981 and are greater than those requested in any

Table 1.1 -- SUMMARY OF BUDGET TOTALS, 1940-1990
(in millions of dollars)

| | Budget Totals (including outlays off-budget under current law, which are proposed to be included on-budget) | | | Components of Budget: Outlays | | | Federal Debt, End of Year | |
|---|---|---|---|---|---|---|---|---|
| | | | | Off-budget under current law; proposed to be included on-budget | On-budget under current law | | | |
| | Receipts | Outlays | Surplus or deficit (-) | | Outlays | Surplus or deficit (-) | Gross | Debt Held by the Public |
| 1975 | 279,090 | 332,332 | -53,242 | 8,088 | 324,245 | -45,154 | 544,131 | 396,906 |
| 1976 | 298,060 | 371,779 | -73,719 | 7,307 | 364,473 | -66,412 | 631,866 | 480,300 |
| TQ | 81,232 | 95,973 | -14,741 | 1,785 | 94,187 | -12,956 | 646,379 | 498,327 |
| 1977 | 355,559 | 409,203 | -53,644 | 8,700 | 400,504 | -44,945 | 709,138 | 551,843 |
| 1978 | 399,740 | 458,729 | -58,989 | 10,359 | 448,370 | -48,630 | 780,425 | 610,948 |
| 1979 | 463,302 | 503,464 | -40,161 | 12,467 | 490,997 | -27,694 | 833,751 | 644,589 |
| 1980 | 517,112 | 590,920 | -73,808 | 14,245 | 576,675 | -59,563 | 914,317 | 715,105 |
| 1981 | 599,272 | 678,209 | -78,936 | 21,005 | 657,204 | -57,932 | 1,003,941 | 794,434 |
| 1982 | 617,766 | 745,706 | -127,940 | 17,331 | 728,375 | -110,609 | 1,146,987 | 929,427 |
| 1983 | 600,562 | 808,327 | -207,764 | 12,357 | 795,969 | -195,407 | 1,381,886 | 1,141,771 |
| 1984 | 666,457 | 851,781 | -185,324 | 9,966 | 841,815 | -175,358 | 1,576,748 | 1,312,589 |
| 1985 estimate | 736,859 | 959,085 | -222,226 | 12,459 | 946,626 | -209,767 | 1,841,077 | 1,513,967 |
| 1986 estimate | 793,729 | 973,725 | -179,996 | 1,501 | 972,224 | -178,495 | 2,074,231 | 1,686,589 |
| 1987 estimate | 861,676 | 1,026,625 | -164,949 | -3,240 | 1,029,865 | -168,189 | 2,308,278 | 1,850,810 |
| 1988 estimate | 950,376 | 1,094,761 | -144,385 | -4,334 | 1,099,095 | -148,719 | 2,546,388 | 1,994,382 |
| 1989 estimate | 1,029,934 | 1,137,390 | -107,456 | -5,307 | 1,142,698 | -112,764 | 2,763,809 | 2,100,971 |
| 1990 estimate | 1,107,673 | 1,190,030 | -82,357 | -6,764 | 1,196,795 | -89,122 | 2,975,163 | 2,182,394 |

Note: Off-budget deficits are equal to off-budget outlays with the sign reversed. For example, for 1975 off-budget outlays under current law were $8,088 million, so the off-budget deficit (-) under current law was -$8,088 million. Legislation is proposed to include all off-budget transactions (outlays and deficits) on-budget.

year since. Moreover, the reductions generally consist of specific proposals and do not include, as in past years, unspecified future reductions or management savings targets.

MAJOR ELEMENTS OF ADMINISTRATION BUDGET

The major elements of the administration's budget program are listed in table 2 of my document. Over the 1986–90 period, revenues would be within $4 billion of the CBO baseline.

Proposed outlay changes, however, would reduce spending by $364 billion. This reduction is the net effect of $43 billion in defense spending increases, $363 billion in cuts in nondefense programs, and a $43 billion reduction in net interest costs resulting from the other spending changes.

The proposed reductions in nondefense programs consist of: $144 billion in reductions in entitlement programs, $187 billion in lower nondefense discretionary spending, and $32 billion in increased offsetting receipts.

The administration proposes particularly deep cuts in Federal credit programs and in grants to State and local governments.

Altogether, nondefense discretionary spending over the 1986–90 period would be cut 19 percent from CBO baseline levels, while the entitlements would be cut only 6 percent. The proposed increase in defense spending and the cuts in nondefense spending would change the composition of Federal spending as set out in table 3 and figure 1. Defense spending would grow from $253 billion in 1985 to $435 billion in 1990 and would reach 7.8 percent of GNP, about the same level as in 1965.

Nondefense discretionary spending, which is already slightly below its 1965 level, would shrink from its current 4.6 percent of GNP to 2.9 percent of GNP in 1990. Social Security and Medicare benefits would remain a roughly constant share of GNP, but the projected decline in other entitlements and mandatory spending would be accelerated.

SPENDING REDUCTION ESTIMATES

CBO's spending reduction estimates are substantially lower than those of the administration—$33 billion instead of $51 billion in 1986 and $364 billion instead of $507 billion over the 1986–90 period. Of the $143 billion cumulative difference, $113 billion is definitional and results from using alternative baseline concepts for national defense.

As noted earlier, CBO uses the appropriation targets in the most recent congressional budget resolution as its defense baseline. Defense outlays are estimated consistently with the assumed budget authority using CBO technical estimating methods. In contrast, the administration measures its defense policy changes from the outlays in the administration's August 1984 mid-session budget review.

CBO AND ADMINISTRATION BUDGET REESTIMATES

Almost all of the differences in budget estimates between CBO and the administration derive from their differing economic assumptions, which are summarized in table 4. Most of the economic differences result, in turn, from differences in assumed interest rates, which become quite substantial in 1989 and 1990.

CBO holds real interest rates constant after 1986; the 3-month Treasury bill rate is a flat 8.2 percent from 1987 through 1990. In contrast, the administration assumes that real interest rates decline steadily after 1987; the Treasury bill rate falls to 5.0 percent by 1990.

The different patterns stem in part from the fact that CBO assumes current budgetary policy, while the administration assumes deficit reductions of $368 billion from 1986 through 1990. The difference in interest rates also reflects the administration's lower inflation assumptions in 1986 and later years. If the effect of administration policies were estimated using administration interest rates, the projected deficit in 1990 would be $65 billion lower than the estimate assuming CBO rates.

The remaining economic differences result from the administration's assumption of more rapid growth in the Gross National Product throughout the 1985–90 period. The administration's projection of nominal GNP exceeds CBO's by $21 billion in 1985, $47 billion in 1986, and growing to $69 billion in 1990. These GNP differences affect revenues, debt service costs and, to a minor extent, noninterest outlays by a total of $4 billion in 1986 and $28 billion in 1990.

In contrast to recent years, technical differences between CBO and administration budget estimates are relatively small.

Table 5 and figure 2 illustrate the effects of the administration's proposals and of different economic and technical assumptions on the deficit projections. Under current budgetary policies, CBO projects that the deficit would rise from $220 billion in 1986 to $302 billion in 1990.

Under the President's program, and using CBO technical and economic assumptions, the deficit would be stabilized at about $186 billion. Using administration interest rates but other CBO assumptions, the deficit under administration policies would decline from $183 billion in 1986 to $122 billion by 1990. Using administration economic and technical assumptions, the decline in the deficit would be even greater—from $180 billion in 1986 to $82 billion in 1990.

Thank you very much.

[The statement follows:]

# PREPARED STATEMENT OF RUDOLPH G. PENNER
## DIRECTOR
## CONGRESSIONAL BUDGET OFFICE

Mr. Chairman, I am pleased to present this afternoon the Congressional Budget Office's (CBO's) analysis of the President's budgetary proposals for fiscal year 1985. Copies of our analysis, which was prepared at the request of this Committee, have been distributed to Members and my statement will summarize its findings.

The Administration's budget proposals this year are very different from those of a year ago. The President's 1985 budget did not recommend major policy changes in terms of either revenues or expenditures. This year, the President proposes a major assault on the projected budget deficits by reducing the growth in government spending. CBO estimates that approval of the Administration's proposals would hold the growth in total outlays to 2½ percent in 1986, compared with 13 percent in 1985. Only minor changes are proposed for federal taxes, and total revenues next year are projected to grow by over 7 percent. As a consequence, the total deficit would decline from an estimated $215 billion in the current year to $186 billion in 1986, or roughly the same level as for 1984.

The budget outlook after 1986 depends critically on what assumptions are made about the performance of the economy. Our analysis of the President's budget is made in terms of changes from the CBO baseline budget projections for the 1986-1990 period. These projections were presented in detail a few weeks ago in the first volume of our annual report

to the Budget Committees. 1/ They provide a basis for evaluating the "static" or "direct" budgetary impacts of proposed changes in spending and tax provisions—that is, the impacts measured before any consideration is given to changes in the economy that might be caused by the policy changes, and to the impacts such changes in the economy might in turn have on the budget.

Using CBO's economic assumptions, revenues and outlays under the Administration's policy proposals would both grow at about the same rate in 1987-1990, and the deficit would remain at about the $186 billion level throughout the period. Under the Administration's economic assumptions, however, growth in revenues would be greater than growth in expenditures and the deficit would continue to decline steadily, falling below $100 billion in 1990.

## THE BUDGET UNDER CURRENT POLICIES

CBO's baseline budget projections assume, for the most part, no changes in current laws governing taxes or entitlement spending. For nondefense spending that is discretionary and subject to annual appropriations, the baseline projections generally assume that the 1985 appropriation levels will be increased to keep pace with inflation. For defense spending, an extrapolation of the 1985 Congressional budget resolution is used as the best approximation of current policy.

Table 1 shows the latest CBO baseline budget projections. The outlay and deficit projections are slight upward revisions of those published earlier

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1. See Congressional Budget Office, The Economic and Budget Outlook: Fiscal Years 1986-1990 (February 1985).

this month and reflect additional information about spending patterns gleaned from the President's budget. Most of the changes in the projections are for public enterprise funds—such as the Agricultural Credit Insurance Fund, Rural Housing Insurance Fund, Postal Service Fund, Low-Rent Public Housing Loan Fund, and Loan Guaranty Revolving Fund—where the Executive Branch has considerable freedom of action in administering the programs.

In relation to gross national product, baseline deficits are roughly stable—at about 5.4 percent of GNP. In dollar terms, however, the baseline deficit rises from $220 billion in 1986 to $302 billion by 1990. With deficits of this magnitude, federal debt held by the public would more than double over the next six years. At the end of 1984, debt held by the public equaled $1.3 trillion, or 37 percent of GNP. By the end of 1990, it would reach $2.8 trillion, or 50 percent of GNP—far above its average of 28 percent of GNP during the 1970s.

For comparability with Administration estimates, the baseline projections of outlays and the deficit include spending that is off-budget under current law. The Administration is proposing that programs currently excluded from the unified budget be included in the budget totals. Like the unified budget deficit, the outlays of these off-budget entities must be financed by borrowing from the public. The Congressional Budget Office has long supported a comprehensive federal budget because it portrays most accurately the economic importance of government activities and gives policymakers the greatest control over spending and tax policies.

TABLE 1. CBO BASELINE BUDGET PROJECTIONS (By fiscal year) a/

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 |
|---|---|---|---|---|---|---|
| | In Billions of Dollars | | | | | |
| Revenues | 735 | 788 | 855 | 934 | 1,005 | 1,088 |
| Outlays b/ | 950 | 1,008 | 1,095 | 1,191 | 1,284 | 1,390 |
| Deficit b/ | 215 | 220 | 240 | 257 | 280 | 302 |
| Debt Held by the Public | 1,526 | 1,745 | 1,984 | 2,240 | 2,519 | 2,820 |
| | As a Percent of GNP | | | | | |
| Revenues | 19.1 | 19.0 | 19.1 | 19.3 | 19.3 | 19.4 |
| Outlays b/ | 24.6 | 24.2 | 24.4 | 24.7 | 24.7 | 24.8 |
| Deficit b/ | 5.6 | 5.3 | 5.4 | 5.3 | 5.4 | 5.4 |
| Debt Held by the Public | 39.6 | 42.0 | 44.3 | 46.4 | 48.4 | 50.3 |

a. The baseline figures are revisions of those appearing in Congressional Budget Office, The Economic and Budget Outlook: Fiscal Years 1986-1990 (February 1985).

b. Includes programs that are off-budget under current law.

## THE ADMINISTRATION'S BUDGET PROGRAM

The Administration's 1986 budget continues the current trends toward higher defense and lower nondefense spending. The proposed reductions in nondefense outlays are similar in size to those requested by President Reagan in 1981, and are greater than those requested in any year since. Moreover, the reductions generally consist of specific proposals and do not include, as in past years, unspecified future reductions or management savings targets.

The major elements of the Administration's budget program are listed in Table 2. Over the 1986-1990 period, revenues would be within $4 billion of the CBO baseline. Proposed outlay changes, however, would reduce spending by $364 billion. This reduction is the net effect of $43 billion in defense spending increases, $363 billion in cuts in nondefense spending programs, and a $43 billion reduction in net interest costs resulting from the

other spending changes. The proposed reductions in nondefense programs consist of:

- $144 billion in reductions in entitlement programs. The largest reductions—$44 billion—would be targeted on Medicare and Medicaid. Farm price supports would be cut by $32 billion, general revenue sharing by $24 billion, and federal employee retirement by $12 billion. No reductions are proposed in Social Security, unemployment insurance, or veterans' income support and education benefits. Only small cuts would be made in means-tested, income-transfer programs.

- $187 billion in lower nondefense discretionary spending. Fifty percent of these cuts can be found in only six areas—$39 billion from eliminating most direct loans by the Farmers Home Administration, $19 billion from lower civilian agency pay, $14 billion from reduced housing subsidies, $9 billion from halving urban mass transit assistance, $8 billion from ceasing to add oil to the Strategic Petroleum Reserve, and $7 billion from eliminating Export-Import Bank direct lending. Another 20 percent of the savings would be achieved in student financial aid, training and employment assistance, highway grants, small business and rural electric loans, health research, and subsidies to Amtrak and the Postal Service.

- $32 billion in increased offsetting receipts. One-third of this increase would come from fees charged to users of government services such as inland waterways, deep-draft ports, customs inspections, nonemergency boating assistance, and meat

inspection. Another third of the increased receipts comes from increasing the premiums charged to participants in Supplementary Medical Insurance (Part B of Medicare). Other proposals include increases in Postal Service payments for employee retirement and the sale of Small Business Administration loan assets and the Conrail system.

TABLE 2. THE ADMINISTRATION'S BUDGET PROGRAM AS ESTIMATED BY CBO (By fiscal year, in billions of dollars)

| | 1986 | 1987 | 1988 | 1989 | 1990 | Cumulative Five-Year Total |
|---|---|---|---|---|---|---|
| CBO Baseline Deficit a/ | 220 | 240 | 257 | 280 | 302 | 1,299 |
| Policy Changes | | | | | | |
| Revenues b/ | -1 | 1 | c/ | -2 | -2 | -4 |
| Outlays | | | | | | |
| National defense | 2 | 6 | 11 | 12 | 10 | 43 |
| Entitlements and other mandatory spending | -14 | -23 | -31 | -36 | -40 | -144 |
| Nondefense discretionary spending a/ | -17 | -32 | -39 | -46 | -53 | -187 |
| Offsetting receipts | -4 | -5 | -6 | -8 | -9 | -32 |
| Net interest | c/ | -3 | -7 | -13 | -21 | -43 |
| Subtotal | -33 | -56 | -71 | -91 | -113 | -364 |
| Total Policy Changes | -33 | -55 | -71 | -93 | -116 | -368 |
| President's Budget as Estimated by CBO a/ | 186 | 185 | 186 | 187 | 187 | 930 |

a. Includes programs that are off-budget under current law.

b. Revenue increases are shown with minus signs because they reduce the deficit; revenue decreases, which are displayed with no sign, increase the deficit.

c. Less than $500 million.

The Administration proposes particularly deep cuts in federal credit programs and in grants to state and local governments. Over the 1986-1990

period, subsidized lending by the Farmers Home Administration, Rural Electrification Administration, Export-Import Bank, Small Business Administration, and other agencies would be cut by $80 billion. The savings in credit subsidy costs would be $48 billion. The Administration contends that borrowers under these programs can find alternative sources of credit and that credit subsidies drive up the interest costs of nonsubsidized borrowers.

Grants to state and local governments would be cut by roughly $105 billion. Programs targeted for cuts are revenue sharing and other general purpose fiscal assistance, Medicaid and public assistance, highways and mass transit, education and social services, community development, and sewage treatment plant construction. The Administration argues that many of the programs provide only local benefits and should not be subsidized by the national taxpayer. It also points to the relatively favorable fiscal position of states and localities vis-a-vis the federal government. Under the Administration's proposals, federal grants to states and localities would represent 1.9 percent of GNP in 1990, as compared with 2.7 percent of GNP in 1985, and 3.7 percent in the peak years of 1977 and 1978.

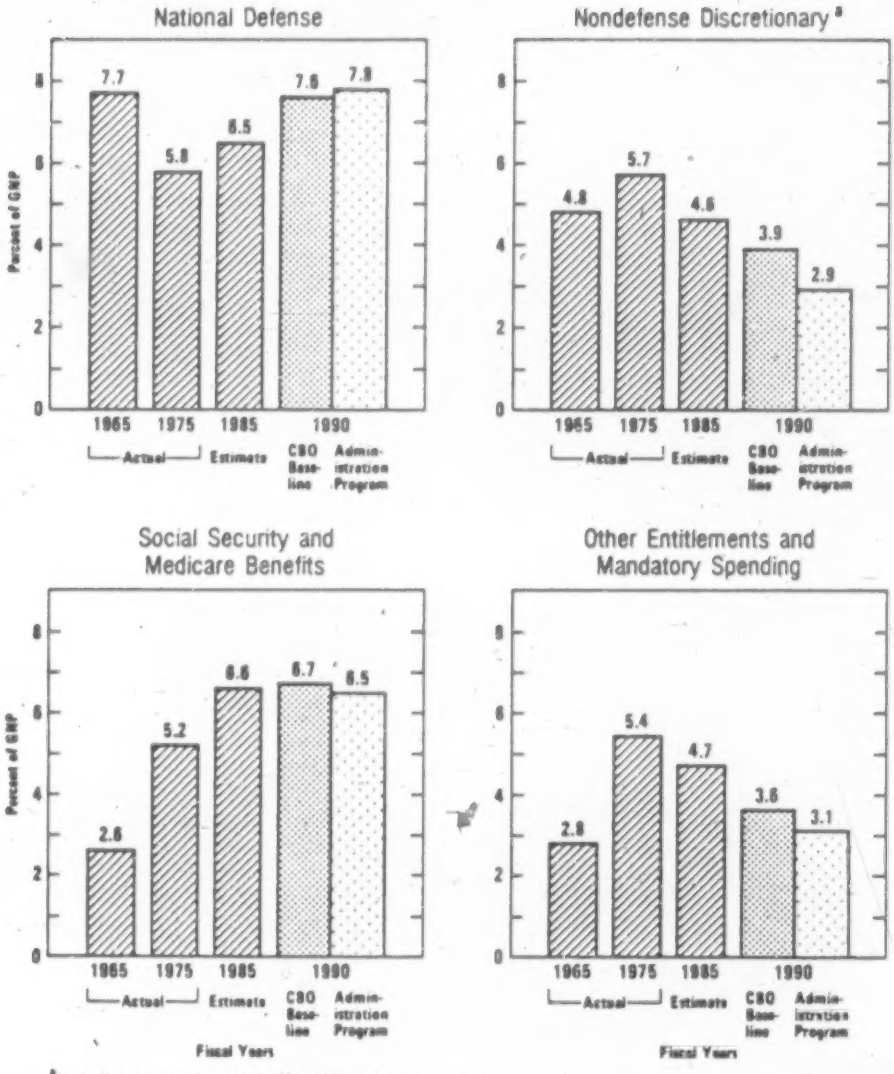
Altogether, nondefense discretionary spending over the 1986-1990 period would be cut 19 percent from CBO baseline levels, while the entitlements would be cut only 6 percent. The proposed increase in defense spending and the cuts in nondefense spending would change the composition of federal spending as set out in Table 3 and Figure 1. Defense spending would grow from $253 billion in 1985 to $435 billion in 1990 and would reach 7.8 percent of GNP, about the same level as in 1965. Nondefense discretionary spending, which is already slightly below its 1965 level, would shrink from its current 4.6 percent of GNP to 2.9 percent of GNP in 1990. Social

TABLE 3. CBO ESTIMATES OF THE ADMINISTRATION'S SPENDING PROGRAM BY MAJOR CATEGORY (By fiscal year)

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 |
|---|---|---|---|---|---|---|
| | In Billions of Dollars | | | | | |
| National Defense | 253 | 284 | 319 | 358 | 396 | 435 |
| Entitlements and Other Mandatory Spending | | | | | | |
| Social Security and Medicare benefits | 255 | 269 | 290 | 313 | 338 | 365 |
| Other entitlements | 182 | 162 | 166 | 167 | 169 | 173 |
| Subtotal | 437 | 431 | 456 | 481 | 507 | 538 |
| Nondefense Discretionary a/ | 179 | 167 | 162 | 164 | 164 | 165 |
| Net Interest | 130 | 146 | 161 | 180 | 195 | 212 |
| Offsetting Receipts | -48 | -54 | -59 | -64 | -68 | -73 |
| Total outlays a/ | 950 | 975 | 1,039 | 1,120 | 1,193 | 1,276 |
| | As a Percent of GNP | | | | | |
| National Defense | 6.6 | 6.8 | 7.1 | 7.4 | 7.6 | 7.8 |
| Entitlements and Other Mandatory Spending | | | | | | |
| Social Security and Medicare benefits | 6.6 | 6.5 | 6.5 | 6.5 | 6.5 | 6.5 |
| Other entitlements | 4.7 | 3.9 | 3.7 | 3.5 | 3.2 | 3.1 |
| Subtotal | 11.3 | 10.4 | 10.2 | 10.0 | 9.7 | 9.6 |
| Nondefense Discretionary a/ | 4.6 | 4.0 | 3.6 | 3.4 | 3.2 | 2.9 |
| Net Interest | 3.4 | 3.5 | 3.6 | 3.7 | 3.7 | 3.8 |
| Offsetting Receipts | -1.2 | -1.3 | -1.3 | -1.3 | -1.3 | -1.3 |
| Total outlays a/ | 24.7 | 23.5 | 23.2 | 23.2 | 22.9 | 22.8 |

a. Includes programs that are off-budget under current law.

Figure 1.
The Composition of Federal Spending




[a]Including programs that are off-budget under current law.

SOURCE: Congressional Budget Office.

Security and Medicare benefits would remain a roughly constant share of GNP, but the projected decline in other entitlements and mandatory spending would be accelerated.

CBO's spending reduction estimates are substantially lower than those of the Administration—$33 billion instead of $51 billion in 1986 and $364 billion instead of $507 billion over the 1986-1990 period. Of the $143 billion cumulative difference, $113 billion is definitional and results from using alternative baseline concepts for national defense. As noted earlier, CBO uses the appropriation targets in the most recent Congressional budget resolution (extrapolated from 1988 to 1990) as its defense baseline; defense outlays are estimated consistently with the assumed budget authority using CBO technical estimating methods. In contrast, the Administration measures its defense policy changes from the outlays in the Administration's August 1984 mid-session budget review. The remaining discrepancy of $30 billion in cumulative savings represents other definitional differences, such as treatment of the manned space station and veteran's medical benefits, as well as different estimates of the budgetary effects of the Administration's policy changes. Among the latter, some of the largest are for national defense, farm price supports, and low-income home energy assistance. In addition, the CBO estimate of the President's program adds over $1 billion in outlays each year for nonmilitary economic assistance for Israel. Although the Administration states in the budget document that a request for appropriations will be forthcoming, no money for Israel is included in the budget totals.

## CBO REESTIMATES OF THE PRESIDENT'S BUDGET

Almost all of the differences in budget estimates between CBO and the Administration derive from their differing economic assumptions, which are summarized in Table 4. Most of the economic differences result, in turn, from differences in assumed interest rates, which become quite substantial in 1989 and 1990. CBO holds real interest rates constant after 1986; the three-month Treasury bill rate is a flat 8.2 percent from 1987

through 1990. In contrast, the Administration assumes that real interest rates decline steadily after 1987; the Treasury bill rate falls to 5.0 percent by 1990. The different patterns stem in part from the fact that CBO assumes current budgetary policy, while the Administration assumes deficit reductions of $368 billion from 1986 through 1990. The difference in

TABLE 4. COMPARISON OF ADMINISTRATION AND CBO ECONOMIC ASSUMPTIONS, 1985-1990 (By calendar year)

| | Actual 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 |
|---|---|---|---|---|---|---|---|
| Nominal GNP (in billions of dollars) | 3661 | | | | | | |
| Administration | | 3948 | 4285 | 4642 | 5017 | 5399 | 5780 |
| CBO | | 3927 | 4238 | 4567 | 4921 | 5301 | 5711 |
| Real GNP (percent change, year over year) | 6.8 | | | | | | |
| Administration | | 3.9 | 4.0 | 4.0 | 4.0 | 3.9 | 3.6 |
| CBO | | 3.5 | 3.2 | 3.3 | 3.4 | 3.4 | 3.4 |
| Consumer Price Index (percent change, year over year) a/ | 3.4 | | | | | | |
| Administration | | 4.1 | 4.3 | 4.2 | 3.9 | 3.6 | 3.3 |
| CBO | | 3.8 | 4.5 | 4.2 | 4.2 | 4.2 | 4.2 |
| 91-Day Treasury Bill Rate (percent) | 9.5 | | | | | | |
| Administration | | 8.1 | 7.9 | 7.2 | 5.9 | 5.1 | 5.0 |
| CBO | | 8.3 | 8.7 | 8.2 | 8.2 | 8.2 | 8.2 |
| Civilian Unemployment Rate (percent) | 7.5 | | | | | | |
| Administration b/ | | 7.0 | 6.9 | 6.6 | 6.3 | 6.1 | 5.8 |
| CBO | | 7.1 | 6.9 | 6.7 | 6.6 | 6.4 | 6.2 |

SOURCE: Congressional Budget Office.

a. Urban wage and clerical workers.

b. The Administration's projection is for the total labor force including armed forces residing in the United States, while CBO's is for the civilian labor force excluding armed forces. In recent years, the former has tended to be 0.1 to 0.2 percentage points below the rate for the civilian labor force.

interest rates also reflects the Administration's lower inflation assumptions in 1986 and later years. If the effect of Administration policies were estimated using Administration interest rates, the projected deficit in 1990 would be $65 billion lower than the estimate assuming CBO rates.

The remaining economic differences result from the Administration's assumption of more rapid growth in the gross national product throughout the 1985-1990 period. The Administration's projection of nominal GNP exceeds CBO's by $21 billion in 1985, $47 billion in 1986, and growing to $69 billion in 1990. These GNP differences affect revenues, debt service costs, and, to a minor extent, non-interest outlays by a total of $4 billion in 1986 and $28 billion in 1990.

In contrast to recent years, technical differences between CBO and Administration budget estimates are relatively small. CBO would reduce the Administration's 1985 deficit estimate by $9 billion for technical reasons--primarily as a result of lower spending estimates for defense, foreign military sales, nuclear waste fees, Medicare, and Social Security. By 1989 and 1990, however, technical estimating differences cause CBO's deficit projections to exceed the Administration's by $11 billion.

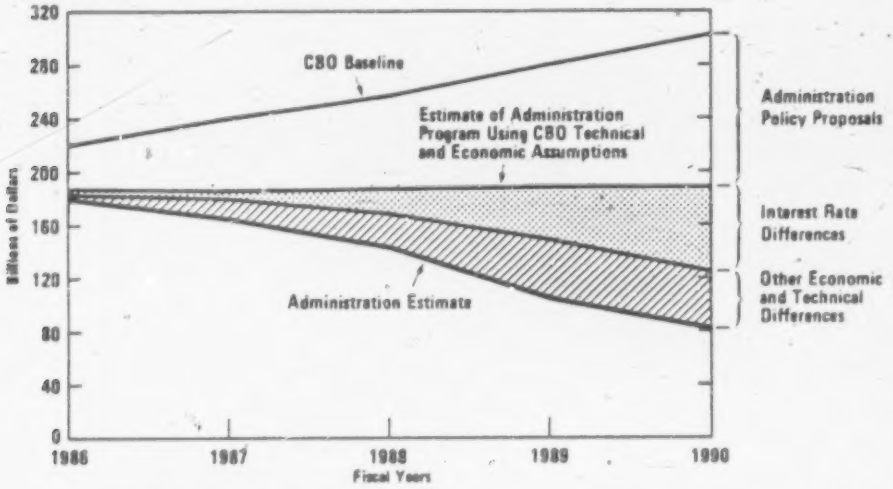
Table 5 and Figure 2 illustrate the effects of the Administration's proposals and of different economic and technical assumptions on the deficit projections. Under current budgetary policies, CBO projects that the deficit would rise from $220 billion in 1986 to $302 billion in 1990. Under the President's program, and using CBO technical and economic assumptions, the deficit would be stabilized at about $186 billion. Using Administration interest rates but other CBO assumptions, the deficit under Administration

policies would decline from $183 billion in 1986 to $122 billion by 1990. Using Administration economic and technical assumptions, the decline in the deficit would be even greater—from $180 billion in 1986 to $82 billion in 1990.

TABLE 5. CBO AND ADMINISTRATION ESTIMATES OF THE ADMINISTRATION'S BUDGET PROGRAM
(By fiscal year, in billions of dollars)

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 |
|---|---|---|---|---|---|---|
| Using CBO Technical and Economic Assumptions | | | | | | |
| Revenues | 735 | 789 | 855 | 934 | 1,007 | 1,090 |
| Outlays | 950 | 975 | 1,039 | 1,120 | 1,193 | 1,276 |
| Deficit | 215 | 186 | 185 | 186 | 187 | 187 |
| Using CBO Technical Assumptions, Administration Interest Rates, and Other CBO Economic Assumptions | | | | | | |
| Revenues | 735 | 789 | 855 | 934 | 1,005 | 1,086 |
| Outlays | 950 | 972 | 1,034 | 1,102 | 1,152 | 1,208 |
| Deficit | 215 | 183 | 179 | 168 | 147 | 122 |
| Using CBO Technical Assumptions and Administration Economic Assumptions | | | | | | |
| Revenues | 736 | 793 | 864 | 953 | 1,029 | 1,108 |
| Outlays | 950 | 972 | 1,033 | 1,100 | 1,148 | 1,202 |
| Deficit | 214 | 179 | 169 | 147 | 119 | 94 |
| Using Administration Technical and Economic Assumptions | | | | | | |
| Revenues | 737 | 794 | 862 | 950 | 1,030 | 1,108 |
| Outlays | 959 | 974 | 1,027 | 1,095 | 1,137 | 1,190 |
| Deficit | 222 | 180 | 165 | 144 | 107 | 82 |

Figure 2.
Federal Deficit Projections




SOURCE: Congressional Budget Office.

Senator CHILES [presiding]. Thank you. Senator Hatfield went to the Floor to vote. I notice Senator Kasten is here now. Maybe he wants to chair.

Senator KASTEN. I will have to go and vote also, Senator. We are going to have to recess then.

Senator CHILES. Senator Hatfield will be back in just a moment. When we get the five bells, we will go at that stage.

Do you have some questions you want to start with then?

HIGH VALUE OF U.S. DOLLAR

Senator KASTEN. Basically I wanted to ask you that there seems to be a growing concern, whether it is the farm crisis or it is the export crisis or whatever, a growing concern over the high value of the dollar, and at the same time a concern about the high rates of interest.

A few days ago the Fed announced that only enough money in credit in 1985 would be provided for the economy to grow at about a 3.5 to 4 percent rate. In other words, they were basing their underlying assumptions on the 3.5 to 4 percent growth rate. They also said the declining interest rates would not continue.

Don't you believe the Fed, number one, with that kind of an economic assumption and an underlying assumption, is playing this whole thing wrong, that money is too tight, and in fact the Fed is the cause of a number of problems we have with exports, and particularly with the lack of farm exports today?

I will ask you to answer that in about a minute because I have to go vote. I know it is hard to do.

Dr. PENNER. First of all, let me be clear that our own economic forecast is based on the assumption that the Fed follows its announced policies with regard to the money aggregates. As I look at that set of policies, that is consistent with anywhere from a 7.5 to, say, 8.5 percent

increase in nominal GNP growth. We are just a little above 7.5 percent in that regard.

CURRENT INFLATION RATE

So the amount of real growth that that is consistent with is clearly dependent on the inflation rate. We have the inflation rate still hovering around 4 percent. That is a very, very high rate of inflation compared to what we have had over our history.

So I think one way of understanding Fed policy—I am not sure the Fed itself would agree with this interpretation—but the way that I understand Fed policy is that the better we do on inflation, the more room there is for real growth.

As to the effects on interest rates and on the value of the dollar, I think that while the Fed can alter interest rates in the short run, interest rates in the longer run are determined by more fundamental factors and that the Fed in terms of the real interest rate is very limited in what it can do over a long, sustained period of time.

So our own analysis would suggest that one of the reasons, perhaps not the entire reason, but one of the reasons for the high real interest rates is the budget deficit itself, and through those high real interest rates we are attracting these very large capital inflows which are pushing up the dollar.

So we see that as the most important nexus holding up both interest rates and the dollar right now.

Senator KASTEN. Thank you, Dr. Penner.

I will give myself unanimous consent for the record to ask a series of questions on monetary policy and economic growth to all three of the witnesses today.

RECESS

Senator KASTEN. The committee will stand in recess until the chairman returns.

[Brief recess.]

RECOVERY IN DANGER FROM DEFICIT

Chairman HATFIELD [presiding]. Let me proceed now. We apologize, Dr. Penner, for these interruptions, but we are not in control of those buzzers at this point.

Let me proceed to change my signals again and start a few questions with you until some of my colleagues have a chance to return.

Dr. Penner, there is a great deal of talk of the possibility of the deficit aborting the recovery. We have heard that this will not happen for at least 2 years from some sources. They usually base it on the good economic news of the year, the real economic growth holding at 6.8 percent, a GNP deflator of 3.5 percent, and so forth.

Do we get another 2 years?

Dr. PENNER. Sir, we don't like that kind of language at CBO. We have never used it. We tend to analyze deficits in the traditional way, which suggests that in the short run they could even provide some stimulus to the economy.

That does not in any way negate the fact that they are very troublesome in the long run because of their potential effect on the living standards of future generations.

On the other hand, it has to be said that we have never tried anything like what we are going through right now in peacetime. These deficits are very, very large compared to anything in past history. Their effects on interest rates and potential effects on inflation are today being mitigated by a very large capital inflow from abroad.

CAPITAL INFLOW FROM ABROAD

Our somewhat optimistic set of assumptions that the recovery will continue and that in the long run economic growth proceeds at quite a reasonable rate by historical standards depends rather crucially on this capital inflow continuing.

One could tell a story, one that we do not attach high probability to, but one could tell a story that would involve the capital inflow drying up very abruptly for one reason or another, perhaps from a loss of confidence in the United States, perhaps because of resurgence of the European economies, or from some other factor. If that happened very abruptly, you would see the dollar go down very rapidly. You would see interest rates rise here. You would see the inflation rate rise here.

It is hard to know what the Federal Reserve would feel was appropriate under those circumstances. But if they felt the need to defend the value of the dollar further, you could through that very complicated chain of events have such a shock to the economy that some sort of recession would ensue.

But I again emphasize that this is not the chain of events we are forecasting, though we do believe that it represents the greatest risk out there to the continued recovery.

Chairman HATFIELD. I believe that was about $172 billion in fiscal year 1984, if I am not mistaken.

LONG- AND SHORT-TERM RESULTS OF FOREIGN CAPITAL

You say you are not forecasting it, but is that based on odds or a kind of likelihood? Would you explain your point regarding foreign capital in both the short term and long term, our dependency upon that?

You say you are not forecasting that situation, as I understand it, a drying up or major diminution of that source, but is that short term, long term, or what are the odds of that drying up or not drying up?

Dr. PENNER. That is very hard to say. In the short term, that is for 1985 and 1986, we are very explicitly forecasting that it will continue. In the longer term, we make what you might call an assumption rather than a forecast, because it is very hard to see that far in the future.

The way we analyze this situation, the inflow is an indirect result of our budget deficit in the sense that the budget deficit puts upward pressure on interest rates, which is one of the factors making this a very attractive environment for investment to foreigners. It is also attractive to Americans who would normally be investing abroad but are keeping a lot more of their money home today.

So given that we see the interest rate intimately linked with the deficit, and given that we are making a current policy forecast in which we

assume the deficit continues, we assume that the capital inflow will continue.

Now, I don't want to say that deficits and interest rates are the only factors motivating capital inflows. Obviously, people are very attracted by the political stability of the United States. They are very attracted by the strong recovery we have had relative to that in European countries.

So there are many things that could change, that could break this link to capital inflows that we are depending on. But we see the probability of that as quite a long way below 50 percent.

Let me say, Mr. Chairman, that while the capital inflows have obviously done some harm to certain sectors of the economy because of their effect on the dollar and on our export industry and import-competing industries, they have been extremely helpful in allowing us to keep capital formation high in the face of the huge Federal deficit.

But foreign capital doesn't come free, either. As we go on, we will owe more and more interest and dividends abroad, and this will in the longer run start to lower the standard of living of Americans because we will be able to keep less of our production at home.

### SLOW EROSION OF ECONOMY FROM DEFICITS

Chairman HATFIELD. Did I understand you in reference to a preface of my question that you do not like to talk in your shop about the deficit aborting the economy?

Dr. PENNER. Well, we just don't like to use that language. We don't see the harm done by deficits as being very sudden. We refer to deficits as being more like a cancer than a heart attack. They eat away at you slowly. We do not forecast some traumatic event resulting from deficits.

Chairman HATFIELD. I was wondering if there was some radical difference because I was quoting from your testimony last year, in which you said there is in fact much talk of the deficit aborting economic recovery. You were concerned about that language only in the context of it coming from outside of your shop last year.

Dr. PENNER. That is right, yes.

### U.S. TRADE DEFICIT

Chairman HATFIELD. Speaking on this matter of inflow of capital, let me take that now into another dimension, and that is relating to the $123 billion trade deficit we have had this year.

What effect do you see a major policy change, such as a lifting of the auto import quotas, having on our trade and overall deficit? Is it possible that a $50 billion increase in the trade dept, if we had that kind of a scenario, could negate a $50 billion cut in spending, if Congress were so successful in bringing that about? Is there a relationship there?

Dr. PENNER. Yes, we think there is a very definite relationship. Now it is controversial within the economic field. Our judgment is that if you were successful in cutting the Federal deficit, that would take pressure off our capital markets, lower interest rates, lower the value of the dollar, and reduce the trade deficit. There are a few people, however,

who believe that if we reduced our Federal budget deficit, the rest of the world would become so confident in our prudence that even more capital would flow in, pushing the dollar higher.

We don't think that would happen, but I feel sure that if it did happen we would have both more savings from foreigners and more savings from having reduced the Federal deficit. I believe that under those circumstances interest rates would plunge in this country to much lower levels, probably down to the levels we experienced in the early 1970's and 1960's or even lower.

GROWTH FIGURES FOR DEFENSE AND NONDEFENSE SPENDING

Chairman HATFIELD. I have one mechanical question. Wy does the CBO use zero real growth for nondefense spending and 5 percent real growth for defense? I believe on page 52 of your "Economic and Budget Outlook Report" you discuss this point. But why don't you project zero real growth for all programs in which there is no statutory indexing?

Dr. PENNER. The concept of current policy is very difficult to apply in any function where you have a lot of big capital investments. It is particularly difficult in defense where, although we appropriate from year to year, we do have a plan involving procurement of certain big weapons systems. Some of those projects, as you so well know, are formulated long in advance—for example, something like a nuclear carrier.

Incidentally, we have the same problems in some of the nondefense sectors as well. For example, we wondered whether the space shuttle should be considered part of current policy in the NASA budget. We decided not to put it there.

But because of this very special problem in defense, we have, as a result of an agreement with the budget committees in the House and the Senate, chosen to use the plan embodied in the Congress' own budget resolution, which last year made room for roughly 5.5 percent real growth, which we extrapolate.

However, in case someone would like to shift gears on that issue, we also provide a baseline that assumes zero real growth in defense.

Chairman HATFIELD. I thank you. Let me defer at this time to the Senator from Florida.

Senator CHILES. I think Senator Lautenberg was here before I was. I would be happy to let him question.

Chairman HATFIELD. You are very gracious, as always, Senator.

Senator LAUTENBERG. As a matter of fact, your grace, if I can use the reference casually—[Laughter]—persuades me, your double grace, persuades me to defer to Senator Chiles.

Chairman HATFIELD. I have some more questions, if you don't want to ask any. [Laughter.]

Senator CHILES. That is all right. I will go forward.

ADMINISTRATION BUDGET NOT GEARED TO DEFICIT REDUCTIONS

Dr. Penner, I have reviewed the Congressional Budget Office's reestimates of the President's budget and the one striking thing to me is that the President's budget is not really a meaningful deficit reduction budget under your reestimates. I would like to review with you some of the key figures that have led me to this conclusion. Those figures appear on page 18 of your report.

Under those figures, it shows that the President's budget adds $43 billion to the defense baseline over the next 5 years, thereby adding to the deficit rather than cutting it in that instance. That is correct under your figures, right?

Dr. PENNER. Yes, sir. That is again compared to this baseline that I just described.

Senator CHILES. Right. Then the President's budget only reduces the deficit by $33 billion in 1986, not by $50 billion under your reestimates.

Dr. PENNER. Yes. Part of that being this difference in definition of baselines.

Senator CHILES. Then that deficit would be about $185 billion in every year through 1990 under the President's budget.

Dr. PENNER. Yes, sir.

Senator CHILES. So the deficit would not be declining over time to $144 billion by 1988, $82 billion in 1990, under your reestimates. It wouldn't decline to that.

ECONOMIC EFFECT OF PROPOSED POLICY CHANGES

Dr. PENNER. Under our estimates, using the same economic assumptions we used for the baseline. As you know, the President is proposing very radical policy changes this year, unlike other years in that regard. We would expect those policy differences perhaps to have some economic effects.

But in order to compare the President's proposals to other proposals—freeze proposals, what have you—we have reestimated them using our baseline economic assumptions.

Senator CHILES. Then under your economic assumptions, with that deficit remaining at about $185 billion to $190 billion for the rest of the decade, the President's program would fail to meet the limited goal of stabilizing the debt-to-GNP ratio after 1988. As I recall, that was a goal that you mentioned as a modest target for deficit reduction when you testified before the Budget Committee a few weeks ago.

Dr. PENNER. Yes, sir. That was with $145 billion as the deficit, as I remember.

GROWTH OF NET INTEREST EXPENDITURES

Senator CHILES. I notice on page 21 of your report, under the President's budget, net interest expenditures grow from $130 billion in 1985 to $212 billion in fiscal year 1990, and that would be an increase of $82 billion.

Dr. PENNER. Yes, sir.

Senator CHILES. Then that being true, while net interest outlays are $49 billion below outlays for all nondefense discretionary programs this

year, those net interest outlays will approximately equal outlays for all nondefense discretionary programs by the year 1987 and would exceed the nondefense discretionary outlays by, under my figures, about $16 billion in fiscal year 1988.

Dr. PENNER. That is correct, sir.

FEDERAL DEBT HELD BY PUBLIC

Senator CHILES. On page 99 of your report, you provide figures on the Federal debt held by the public. Under those I think you show that the debt will cross the $2 trillion mark in fiscal year 1988 and then the debt subject to the statutory limit, which Congress must vote to increase, would cross the $2 trillion mark in this fiscal year under the President's budget proposal.

Dr. PENNER. In fiscal 1986, sir?

Senator CHILES. Fiscal 1986, yes.

Dr. PENNER. I want to check that, sir, but I think that is correct, yes.

Senator CHILES. I will wait until you get that checked.

Well, let me just ask you this: Whether it crosses in 1986, and I think it does——

Dr. PENNER. Sir, I have the exact number in answer to your previous question. The debt subject to limit at the end of 1986 would be $2.1 trillion.

Senator CHILES. So it does cross that.

Dr. PENNER. Yes, sir.

REDUCED STANDARD OF LIVING FOR FUTURE GENERATIONS

Senator CHILES. So won't that have to result in the reduction of the standard of living of our children or our grandchildren when they have to pay it back, particularly since we are funding the deficit out of at this time foreign borrowing and not domestic savings?

Dr. PENNER. We believe, sir, that any deficit, or perhaps putting it the other way around, any reduction in deficits does improve the prospects for the living standards of future generations. I would say either way.

If we were living in a closed economy, you would expect that deficit to reduce our capital formation, our productivity and standard of living in the future. If we are able to borrow abroad, we can keep our capital formation high. But as I noted before, while we can keep our production high, more and more of it has to be devoted through time to paying interest and dividends abroad and, therefore, we have less left over for ourselves. So either way I think it does cut the future living standard.

Senator CHILES. Thank you, Mr. Chairman.

Chairman HATFIELD. Senator Lautenberg?

STATEMENT OF SENATOR LAUTENBERG

Senator LAUTENBERG. Thanks, Mr. Chairman. First, if I might call it a housekeeping matter, Mr. Chairman, I would like the opportunity to submit an opening statement that I had for the record.

Chairman HATFIELD. The Senator's opening statement will be incorporated in the record.

Senator LAUTENBERG. Further, if I might take a minute of Dr. Penner's time, to say that I look forward to working with you and other members of the committee. I know that you and Senator Stennis have a clear record of getting to the issues, where necessary, and where possible to put the partisanship aside. I look forward to being in that environment, not to suggest that the other committees I sit on don't have such a mission. But that was one of the understandings I had. I look forward to working with other of my colleagues on the committee.

Chairman HATFIELD. If the Senator would yield. Before my colleagues from Florida and Arkansas had arrived, I exercised the privilege of the chair in welcoming our new member, Senator Lautenberg of New Jersey. I hope that I could speak for you as well.

Senator CHILES. Certainly.

Senator BUMPERS. I will take that under advisement. [Laughter.]

Senator LAUTENBERG. I was afraid of that.

Chairman HATFIELD. Let's not reopen that question at this point. [Laughter.]

Senator Lautenberg. We had his grace all right, but I wasn't sure about—[Laughter.]

In any event, Dr. Penner, we have had a chance to meet before. I appreciated very much your testimony.

One thing that lurks, of course, in the background is the challenge to assumptions being made by various very responsible groups. I am sure Mr. Schultze would agree about the science of economics and how we all use the same data and come out with different conclusions. That will never cease to mystify me, even though in my former iteration I used to sell a data base developed by someone from my other party and we sold it confirming the fact it was absolutely guaranteed to have all of its projections unquestionably right. I am sure Mr. Greenspan, who developed the data, would agree. Here we are, however, in a different environment.

The economic and budget outlook document suggests a scenario in which the national debt could explode out of control simply due to the cost of debt service, and the factor that you have mentioned several times here is the relationship between nominal interest rates and the GNP growth, nominal GNP growth, where interest rates exceed GNP growth.

So therefore, is it possible that even if we balance the budget, that national debt would increase as a share of GNP?

Dr. PENNER. The arithmetic of that depends very importantly on what happens to the deficit in excess of the interest bill on the debt. I think one can get an intuitive feel for that. If one assumed that the deficit was exactly equal to the interest bill on the debt and the interest rate on the debt was 10 percent, then obviously the outstanding debt would grow at 10 percent. So if GNP was growing at 10 percent, the same as the interest rate in this example, the debt-to-GNP ratio would remain exactly constant.

Now as you have pointed out, our assumptions involve an interest rate somewhat greater than the rate of growth of GNP. In that case, to keep the debt-GNP ratio constant, you have to have a surplus in the noninterest accounts of the government. So you could still have some total deficit. As long as it was less than the interest bill on the debt, you could stabilize the debt-GNP ratio.

Senator LAUTENBERG. Well, how serious a risk is this under current policy?

Dr. PENNER. I think a year ago at this time it was a substantial risk because at that time we were projecting a deficit that grew not only in absolute terms but faster than the GNP. Last year we had the deficit going up from something over 5 percent to 6 percent of the GNP level, and we truly did seem to be on an unstable path.

The downpayment on the deficit passed by the Congress last year was very important to this arithmetic because at least it stabilized the ratio of the debt. If you look at our baseline assumptions now, the deficit is stabilized at between 5 percent and 5.5 percent of the GNP. So we are off this unstable path, but I should note just barely.

You noted the problems of projecting what the economy will do in the future. If things turn out to be somewhat worse than we project, we could find ourselves back on that unstable path.

I note that with regard to the issue of uncertainty that you raised, which I think is a very important issue, we have in volume one of our report outlined various scenarios and various sensitivity analyses to indicate what would happen if our projections and forecasts are wrong.

TREASURY BILL RATE

Senator LAUTENBERG. The assumptions made on the T-bill rate, I was looking for the section of your remarks that made reference to that. Can you help me?

You use an average rate. This is 90-day treasury bills, right?

Dr. PENNER. Yes, sir.

Senator LAUTENBERG. You use roughly an average of 8, 8.5 percent.

Dr. PENNER. Yes. More precisely, for 1985 we have an average of 8.3 percent and for 1986 8.7 percent and then we keep the real interest rate constant after that, which implies a nominal rate of 8.2 percent for the rest of the period.

Senator LAUTENBERG. The rates used by OMB are considerably more optimistic, and I am still looking for that.

Dr. PENNER. I have those right here, sir, if you like. They start off with an average for 1985 of 8.1 percent. That falls to 7.2 percent in 1987 and then falls quite dramatically to 5 percent in 1990.

Now, of course, it should be pointed out that we are projecting the implications of current policy, whereas they are projecting a different set of policies in which spending is cut quite dramatically. So the two forecasts aren't precisely comparable.

Senator LAUTENBERG. Right. The data goes into it being considerably different. Of course, we are looking at a period of time very recently in which interest rates have been inching up markedly, not in great leaps each day, but there have been significant changes in the marketplace.

Dr. PENNER. Yes, sir.

FORECASTING INTEREST RATES

Senator LAUTENBERG. We can't make a 5-year forecast based on a couple of weeks of activity. But certainly to me, doesn't look like the pressure is on the downside for interest rates. I guess, however, we have to wait until we see how we wrestle it out on the Floor before we can discuss those much further.

Dr. PENNER. In an appendix to our report, we are brave enough to describe our forecasting errors of the past, and it shows very clearly that the thing we are worst at is forecasting interest rates, which has become absolutely crucial to the budget outlook simply because the debt has grown so much. Indeed, a one percentage point error in our interest rate forecast carried through 1990 would imply a $31 billion error in forecasting the budget deficit.

Senator LAUTENBERG. Perhaps we today have coined Penner's Law, that mistakes made in the past are likely to be repeated in the future. [Laughter.]

Is there a danger that revenues left—I don't want to get you in that kind of a situation. I will pass.

Chairman HATFIELD. Senator Weicker?

Senator WEICKER. No questions.

Chairman HATFIELD. Senator Sasser?

Let me just say for the members who have arrived, Professor Weidenbaum and Professor Schultze will deliver their testimony after we finish questioning Dr. Penner. Then we will ask them questions at the end of their testimony.

Senator SASSER. Thank you, Mr. Chairman. I will be very brief with Dr. Penner here.

REDUCED DEFICIT MAY RESULT IN WEAKER DOLLAR

Dr. Penner, you have testified, I think today, that as the deficit comes down, you would anticipate that the value of the dollar would go down on the international currency market because as the deficit comes down, interest rates would come down, domestic interest rates, and this would pull down the value of the dollar on the international market.

Are you aware that the other day, before the Budget Committee, Treasury Secretary Jim Baker, in response to one of my questions, indicated that if the deficit should come down, he would anticipate the dollar to become stronger on the international market and to go up?

Dr. PENNER. I wasn't aware of him saying that, Senator, but I know there are quite a few people who believe that. I heard Henry Kaufman say that.

I think, however, what that would imply basically is that if we reduced our deficit, foreign investors would become even more confident in the long-run future of the American economy, investing more here. While I can't rule out that possibility—as I said, that is not our judgment as to what would happen—I would argue that if it did occur, because you would have more foreign savings in this country, you

would have more domestic savings released by reducing deficits, and under these circumstances you would see interest rates really plummet, probably to the low real levels that we had in the 1960's and early 1970's.

PROBLEMS CAUSED BY STRONG DOLLAR

Senator SASSER. Mr. Chairman, you might find this interesting. I asked Secretary Baker about what would happen if we got our deficit under control or did a better job with it, and he says, "You know, our trading partners tell us that our high deficit is the cause of the strong dollar and, therefore, we ought to do something about our deficit. But I have never known an economy, and I am not an economist, but I have never heard of a economy that got its fiscal affairs in order and had its currency weakened. If we do something about our deficit, it is not unlikely that our dollar could get even stronger."

So that is not much encouragement to do something about the deficit, because one of our problems with our farmers, the reason they are going out of business by the tens of thousands, is the strength of the dollar in the international currency market, as you know.

Dr. PENNER. Well, again, although that is not my judgment, I would reiterate that if it happened, interest rates would really plummet. That, of course, would offset some portion, if not all, of the harm done to export sectors by a stronger dollar.

LONG RUN DECLINE IN U.S. STANDARD OF LIVING

Senator SASSER. Dr. Penner, some economists have begun to focus on the long run decline in our standard of living that could come as a result of the accumulation of a massive indebtedness. The link has been drawn, just as you did in your testimony, between the rise in the debt-to-GNP ratio and the result of a slowdown of investment in productivity growth and a decrease in the standard of living. Some have described our present economic situation as an economy being on a consumption binge, financed by running down our accumulated international assets. The ensuing debt will have to be paid and interest by us and our children. Do you agree with this characterization?

Dr. PENNER. To some degree. I think the capital inflow has also let us have something of an investment binge. We have kept investment very high in this recovery. That is obviously good.

But just to give you some numbers on the phenomenon that you are referring to, the important question there is how much of our production can we keep.

If you look at the amount of income that we are getting from abroad, already you see the signs of that eroding. That is mostly net interest and dividends. In 1979, it peaked at 1.78 percent of Gross National Product. It has steadily declined. In the last year, it declined at an increasing rate. It is still at 1.23 percent. So we have only lost half a percent. The decline is very slow.

That is one of the real problems in confronting this thing, that the effects are very slow. But they are inexorable and they accumulate through time.

All I am saying is you can already see the phenomenon that you referred to occurring.

Senator SASSER. That is a reduction in the standard of living?

Dr. PENNER. That implies, yes, that our national income is eroding relative to the total amount we produce in this country.

PREDICTIONS OF ECONOMIC DISASTER

Senator SASSER. One final question, Mr. Chairman. We have heard respected economists from both sides of the spectrum over the past 2 or 3 years, Dr. Greenspan on the one hand to Dr. Heller on the other side, and two distinguished economists I see sitting in this audience today who will shortly testify, Henry Kaufman somewhere in the middle, I suppose, telling us unless something is done about these deficits, there is going to be an economic fiscal catastrophe awaiting us, and the deficits have continued to grow. We have stabilized, as you indicated, the relationship between the deficit and GNP last year. But things are going great guns.

We see the highest rate of growth in real personal income in 21 years. Inflation rates are at their best level in almost 20 years, GNP numbers are, what, last year a 5 percent, 4.9 percent growth in GNP.

What has happened to all of these predictions of disaster that we had been hearing for a number of years? Where is this disaster that was right around the corner, Dr. Penner? When will it occur?

Dr. PENNER. I don't think we have ever predicted one would occur.

Senator SASSER. I am not talking about the CBO.

Dr. PENNER. But the more fundamental point, as I have said before, is that what we are doing is proving that we can live very well on borrowed money, as long as people are willing to lend it to us.

The chairman raised the issue earlier in this discussion about how long will people be willing to lend it to us. Our optimistic forecast, as I said before, assumes that people are willing to keep putting it in. So we do not predict a catastrophe or any traumatic event in the future.

I will say, however, I was more inclined to the catastrophic view around 1982. I was a private citizen at that time. But it should be noted that the Congress has done an awful lot to the deficits we were projecting at that time. We have, after all, had four tax increases of some considerable magnitude in the last 3 years: TEFRA, the gas tax (which was spent but we might have spent that otherwise), the Social Security reforms that helped a lot, and of course the Deficit Reduction Act, which was very important to our projections. So as you put it, we stabilized the deficit-GNP ratio when it was exploding.

Now as Senator Lautenberg said, in our report we do outline a true catastrophe theory where you don't have the deficit-GNP ratio stabilized and the interest grows and grows and at some point it grows so fast that there is no hope of offsetting it by either cutting spending or raising taxes. At that point you have to repudiate the debt, and you can either do that explicitly, which would be the equivalent of bankruptcy for a household, or you can finance government by printing money. That is the more typical solution. It is the story in Israel, and it has

been the story in a lot of Latin American countries with huge inflation rates. That I would regard as the true catastrophe.

But I think the congressional actions of the last number of years have taken us off that path. What we have to worry about now is not so much catastrophe as what we are doing to the living standards of our descendants.

As I said before, it happens very slowly. You can't point to any particular traumatic moment.

Senator SASSER. I said that was my last question, but I have one more short one, Mr. Chairman.

Dr. Penner, I want to commend you. You are the first person that I have heard say something kindly about the Congress in relation to the deficit [laughter] in my 8 years of service in this body. This is a memorable occasion. [Laughter.]

I hope it is duly noted by the press over there and widely reported. [Laughter.]

INVESTMENTS IN CENTRAL AND SOUTH AMERICA

One final question. Chairman Paul Volcker indicated the other day, when he appeared before the Senate Budget Committee, that yes, indeed, things were on the surface going very well, but he drew the analogy between ourselves and countries in South America, or countries to the south of us. He indicated things were going very well for them. People were rushing down there to lend money, and some of our bankers couldn't tee off at the Westchester Country Club unless they had a couple million dollars south of the border. That was a great status symbol.. But that turned around almost overnight.

Do you see that kind of overnight turnaround as a scenario we might anticipate?

Dr. PENNER. Our forecast implies that the whole situation is dependent on people lending us money at interest rates that are not too different from today's. We do not forecast that it will turn around. We don't see any event on the horizon that would cause a dramatic turnaround in any of those flows. But it still remains the risk that we worry about most.

Senator SASSER. Thank you, Mr. Chairman.

Chairman HATFIELD. Thank you, Senator.

CURRENT SERVICES VERSUS RADICAL POLICY CHANGE BUDGETS

On behalf of Senator Domenici, I have been asked to pose one question to you. Dr. Penner, did I understand you when you were responding to Senator Lautenberg that the CBO estimates and projections are based upon current services, a current service budget, whereas the President's projections are based upon a radical change in policy?

Dr. PENNER. That is correct, sir. He bases his economic forecast on his policy.

Chairman HATFIELD. Then based on that assumption, given the President's policy change recommendations and his forecast, do you think those forecasts are reasonable?

Dr. Penner. There are really two issues. First of all, sir, the forecast errors related to any given set of policies. And as Senator Lautenberg said, they could be quite large.

The other issue is the uncertainty and controversy among economists as to what any change in policies does to the economy.

When you add up those two uncertainties, I cannot say that the President's assumptions are unreasonable.

Chairman HATFIELD. Thank you very much, Dr. Penner. We appreciate your presence here today. We will now excuse you. We do have some questions for the record which we will submit to you in writing.

[The following questions were not asked at the hearing, but were submitted to the Department for response subsequent to the hearing:]

## QUESTIONS SUBMITTED BY SENATOR HATFIELD

### LOW-GROWTH DEFICIT FORECAST

Question: In your baseline study, you display a "low-growth" baseline projected deficit of $425 billion in FY 1990. That number is truly frightening.

What is your estimate of the Administration's budget deficit in 1990 under the CBO "low growth" projection?

Answer: Using its alternative low-growth economic assumptions, CBO estimates that the deficit would reach about $320 to $330 billion in 1990, even assuming all of the President's proposed spending and tax changes.

### CBO ESTIMATE OF OCS SALES

Question: On February 20, 1985, the Secretary of the Interior announced that he was delaying or canceling four pending OCS oil and gas leases.

Is the effect of these delayed or canceled OCS leases incorporated in your estimates. If so, what is the budgetary impact?

Answer: The February 20, 1985 announcement of four delayed or cancelled Outer Continental Shelf (OCS) lease sales does not significantly affect the CBO estimate of OCS receipts. In estimating OCS receipts for the baseline, CBO already accounted for the indefinite delay of Sale #88 (Cook Inlet). The CBO estimate of $5.48 billion in OCS receipts for 1985 does, however, include the bonus receipts expected from Sale #90 (South Atlantic), which had been planned for July 1985. This was expected to be a small sale, and receipts were projected to be only about $30 million. The postponement of Sale #86 (Shumagin) and cancellation of Sale #99 (Kodiak), both originally scheduled for fiscal year 1987, do not affect our estimates of OCS receipts. Because there is little resource information for OCS lease sales that are more than two years away and because the leasing schedules are so uncertain, CBO does not attempt to estimate the bonus receipts on a sale by sale basis for such years, as we do for those sales scheduled for the current and budget year. Rather, CBO's baseline projections of bonus receipts for fiscal years 1987 through 1990 are set at the $2.5 billion estimated for 1986. Since bonus receipts from individual lease sales are not directly reflected in the 1987 estimate, changes in the 1987 schedule do not affect CBO's baseline projections.

The table below presents CBO's estimate of the bonus receipts expected from the lease sales affected by the February 20th announcement:

| Sale | Current Sale Date | Total Estimated Bonus Bid (in millions of dollars) |
|---|---|---|
| 88 (Cook Inlet) | Unknown | 195 |
| 90 (South Atlantic) | Unknown | 30 |
| 86 (Shumagin) | December 1987 | No Estimate |
| 99 (Kodiak) | Cancelled | No Estimate |

## OMB SCORING OF RESCISSIONS OF PRIOR-YEAR BALANCES

Question: In the most recent circular A-11, OMB directed agencies not to score rescissions of prior-year balances as reductions in budget authority. Using the OMB method, Congress gets no credit during the last session for rescinding $7.375 billion in previously appropriated synfuels funds. Is it not appropriate to give us credit for our rescissions when previous appropriations action gives us credit (or blame) for the budget authority?

Answer: As you observed, Mr. Chairman, OMB has changed their scoring of rescissions of unused budget authority appropriated in prior years. Instead of showing these rescissions as reductions of new budget authority in the current or budget year, OMB is now showing them as reductions of unobligated balances. This would have the effect of not giving the Appropriations Committee any credit for the rescission last year of the synfuels funds appropriated several years ago.

This change in the budget treatment of rescissions, however, has not been adopted by the House and Senate Budget Committees for Congressional scorekeeping purposes. Therefore, the Appropriations Committees will still get credit for all rescissions, even though the budget authority being rescinded may have been appropriated in a previous year.

## SALARIES AND EXPENSES

Question: The President assumes in his budget for FY 1986 that certain changes relating to pay have already been enacted into law. First, he assumes that a 5 percent reduction in civilian pay for FY 1986 has been enacted. Second, he assumes that a 3 percent increase in military pay has been enacted, effective July 1985.

By how much can we reduce the defense budget if no such change in military pay occurs?

Answer: If the proposed 3 percent increase in military pay does not take effect in July 1985, the President's fiscal year 1986 defense request for military personnel accounts could be reduced by $1.8 billion in budget authority and outlays. This amount would be offset by a $0.5 billion increase in budget authority and outlays in the function 950 employer's share of military employee retirement account. Budget authority for the function 600 military retirement accrual trust fund would decrease by $0.5 billion. This would result in net reductions of $1.8 billion in budget authority and $1.3 billion in outlays.

Question: By how much must we increase the President's proposed DoD and non-DoD salary and expenses accounts if civilian pay is frozen in FY 1986 rather than reduced?

Answer: If the proposed 5 percent reduction in civilian pay does not take effect in January 1986, the President's fiscal year 1986 request for salaries and expenses would have to be increased by $1.8 billion in budget authority and outlays. Of this amount, $0.8 billion would be for Defense Department civilians, and $1.0 billion would be for civilians in nondefense agencies. The $1.8 billion would be offset by a $0.2 billion decrease in the function 950 employer's share of civilian employee retirement account. This would result in a net increase of $1.6 billion in budget authority and outlays.

## TREATMENT OF OFF-BUDGET SPENDING

Question: Under existing law, off-budget spending is not contained in the unified budget. You have chosen to display the President's request as if the President's as yet unsubmitted proposal for merging off-budget and on-budget spending had already been enacted. Why?

Answer: We did this for two reasons. First, the President's budget was presented in this fashion and to provide comparability with Administration estimates, we did the same. Second, the Congressional Budget Office has long supported a comprehensive federal budget because it portrays most accurately the economic importance of government activities and gives policymakers the greatest control over spending and tax policies. Like the unified budget deficit, the outlays of off-budget entities must be financed by borrowing from the public. Therefore, we believe the best way to look at the federal budget is to combine the off-budget spending with on-budget spending.

## TAX EXPENDITURES

Question: In the President's Budget, in Special Analysis G, Tax expenditures, he sets forth lists of tax expenditures but provides no totals.

Have you tallied the Administration's estimates of tax expenditures?

Will you please provide that information to the Committee?

Answer: Neither CBO, the Joint Committee on Taxation, nor the Treasury Department routinely calculates tax expenditure budget totals. While estimates of individual tax expenditures may permit useful comparisons with similar direct outlays, the arithmetic total of several or all the tax expenditure estimates has significant limitations. Since the cost of each tax expenditure is estimated by determining how much additional revenue would be collected if the provision did not exist, some special problems are introduced when more than one tax expenditure is involved.

Several general examples may help illustrate this point. If three or four tax expenditures that take the form of personal deductions did not exist, for example, more taxpayers use the standard deduction (zero bracket amount), and the estimated net revenue cost would be less than if the deductions were estimated separately and then summed. In this case, the standard deduction would absorb part of the cost that would otherwise be assigned to the tax expenditures. On the other hand, if three or four tax expenditures that took the form of exclusions from income no longer existed, more income would be taxed at higher marginal tax rates, so that the estimated joint cost of several exclusions would be more than if the exclusions were estimated individually and then added together. The simple aggregation of several tax expenditures, in other words, often does not provide an accurate estimate of their joint cost. The problem is even greater for a grand total. If other tax expenditure estimates might be of use to you, we will be happy to supply them.

# QUESTIONS SUBMITTED BY SENATOR KASTEN

## MONETARY QUESTIONS

Question: Gentlemen, a few days ago, Paul Volcker said that he intends to supply enough money and credit in 1985 for the economy to grow at

about a 3.5 to 4 percent rate. He also indicated that the decline in interest rates would not continue. Do you think that Chairman Volcker's range for economic growth--and hence monetary growth--is too conservative? Do you think that a more expansive monetary policy would provide a better chance for maintaining our economic recovery?

Answer: Economic growth in the 3½ to 4 percent range is quite typical for the third year of a recovery. The normal pattern is for growth to be very strong early in the recovery, producing large declines in unemployment and strong growth in investment and inventories. As the recovery matures, capacity utilization rates rise, bottlenecks appear in the economy and eventually inflation rates (in the third or fourth year of the recovery) tend to rise. One goal of economic, and particularly monetary, policy is to avoid stimulating the rate of economic growth as capacity limits are approached. It is not often easy to decide when or by how much growth should slow--the capacity utilization rate reported by the Federal Reserve, for instance, suggests that the exceptionally strong growth in this recovery has brought activity quite close to where inflation might accelerate, while the unemployment rate remains well above the rate at which most economists would expect an acceleration in inflation. CBO does not anticipate an acceleration of inflation due to excessive growth in the next two years, if real growth rates are close to those anticipated by CBO, the Administration and the Federal Reserve.

While stronger economic growth than in past recoveries would offer a chance for improving standards of living, and reducing unemployment and poverty, it thus also increases the risk of higher inflation. Most economists would agree that an attempt to use very expansive monetary policy to produce growth would lead in a year or so to an acceleration of inflation, and would in the long run have little effect on growth. Higher growth that results from improvements in the productive potential of the economy, on the other hand, does not carry the same risk of accelerating inflation. Thus if evidence appears of a favorable shift in velocity--the relationship between money growth and nominal GNP growth--or of lower inflation, somewhat higher real GNP growth might be consistent with the Federal Reserve's money targets.

## ECONOMIC GROWTH QUESTIONS

Question: Last week, the Commerce Dept. reported that the economy grew at a rate of 4.9 percent in the last quarter of 1984. That's a full percentage point higher than they had expected. And, despite the forecasts of many "experts", the economy grew at a rate of 6.9 percent last year. All in all, the economy has grown at about a 6 percent annual rate over the two years since the recession that ended in 1982--faster than any upturn since 1951.

The budget resolution for FY 1985 also assumed that the economy would grow slowly. It assumed a range of 5.4 percent in 1984--a full 1.5 percentage points less than reality.

The Administration has forecast a growth rate of 3.9 percent for the next calendar year.

- What are your projections for growth next year?
- Do you think the Administration's estimate for growth is too conservative?

- What steps can and should we take to get a better indicator of economic performance?

Answer: CBO forecasts real GNP growth of 3.5 percent in calendar 1985, slightly below the Administration's forecast of 3.9 percent. This is a small difference, given the difficulty of forecasting a year ahead, and even, as you point out, of knowing what the growth rate actually was in the last quarter of 1984. The upward revision of the growth estimate for 1984 starts 1985 out at a higher level, but it does not necessarily mean that the growth rate will be higher for the calendar year. Much of the revision was the result of a decline in imports from their very high levels of last summer. The exchange rate has risen more than 7 percent above its fourth-quarter average, and many people expect a further deterioration in our international accounts as a result. And as you have noted, the CBO and Administration forecasts for real growth are consistent with the current intentions of the Federal Reserve. It is too early, given this and other uncertainties, to say whether the Administration's forecast, or ours, is too conservative for 1985.

## Questions Submitted by Senator Leahy

### STATE BUDGETS

Question: For the most part, state budgets are in balance. If state budgets were configured as the federal budget is, would state budgets be in balance?

Answer: In a 1979 study conducted for the Congressional Budget Office at the request of the House and Senate Budget Committees, the consulting firm of Peat, Marwick, and Mitchell recast the budgets of four states to the federal accounting basis. The results varied among the states. The reported balances of two states—California and Maryland—worsened, and in Maryland a surplus was converted to a deficit. On the other hand, the reported balances of the two states (Illinois and New York) improved, and a deficit in Illinois was converted to a surplus.

A fifty-state, present-day study of this type would likely show a similar range of results. Such a study would require careful data collection and analysis, for state accounting and spending practices are extremely variable. Without such a study in hand, CBO cannot calculate the aggregate change in the reported balances of the states that would result from such a recasting.

Question: Specifically, do state budgets treat capital spending in the same way as the federal government does?

Answer: The budgetary treatments of capital spending by federal and state governments differ substantially. The federal government generally records the costs of capital projects in the budget as capital outlays are made. This is often not the case for state governments. "Typical" states finance projects with special bond offerings, and show the amortization costs (debt service) of these offerings in the budget, though usually not in the years in which the outlays are made. The capital outlays are recorded in the special funds in which the proceeds of the special bond offerings have been placed. Some states may exclude the debt service costs from the operating budget, and others finance selected capital projects out of current revenues and report these outlays in the operating budget.

Question: If the federal budget were developed in the same way as the state budgets are (for example, with regard to capital investment), how would this affect the level of the federal deficit? (If a precise answer is not possible, please provide a general estimate.)

Answer: CBO cannot calculate the effect of such a recasting because, as stated above, the necessary information about state accounting practices is not available. In addition, the variability of state practices would make it necessary to recast the federal budget to a number of alternative state models. It is possible, however, to discuss the major differences between federal and "typical" state practices.

The most important difference is the lack of a "unified budget" for many of the states. States exclude many of their expenditures and receipts from their general or operating funds, including those for capital, pensions, and debt service. The effects of exclusion of similar funds from the federal budget would differ by type of fund and even by year. For example, if the expenditures for highways and the excise tax receipts of gasoline that are dedicated to transportation had been excluded from the budget in 1979, the reported deficit would have been $891 million smaller. In 1980, a similar exclusion would have resulted in a reported deficit that was $1,565 million larger. Similar timing effects would result from exclusion of pension accounts from the budget. In principle, such exclusions are likely to have relatively small effects over time if the budget accurately reflects total expenditures and receipts. In practice, the states account for and fund pensions in such different ways that the effects of adopting the states' practices at the federal level would lead to varying results.

Another important difference is the state practice of carrying over the various years' surplus (or deficit) in the general fund for use in the budget year. In other words, the cash balances of the state governments are counted as budgetary revenues that are available to offset expenditures. The federal government does not count cash balances as receipts, but as a "means of financing" a deficit. It still reports a deficit if available cash balances are sufficient to cover the shortfall of revenues to cover outlays.

It should be noted that although modifications of current federal accounting practices might change the level of the reported deficit, these modifications would not in themselves change the level of borrowing required to cover the shortfall of revenues against outlays.

## Questions Submitted by Senator Bumpers

### CBO FORECASTING

Question: In your testimony you point out that, under your economic assumptions regarding interest rates and GNP growth, federal deficits, under the President's budget proposal, will stay in the $180-$190 billion range for as far as the eye can see. Would you regard your forecast as a "most likely" or middle-of-the-road forecast? And do you think it is prudent and reasonable to base federal budget policy on anything other than a "most likely" scenario?

Answer: In the early history of the budget process, economic assumptions were often viewed as goals for the economy. Not surprisingly, these assumptions often proved optimistic. Given this experience, I believe that the economic scenario chosen for budgeting purposes should be realis-

tic, that is, it should represent the most likely outcome, given the fiscal policy being considered. Ideally, it should also be a realistic basis for comparing the likely budgetary outcomes of different fiscal policies. And if possible, the economic assumptions should not be a focus of controversy, thus drawing attention away from the difficult budgetary decisions themselves. These desiderata are difficult to achieve, and may even be inconsistent, so CBO must emphasize the first criterion.

CBO's economic projections for the period 1985-1986 are conditional forecasts: that is, they are our best guess as to what will happen, given the assumption of no change in budget policies in place. (It is not part of our mandate to try to predict what Congress will do, so CBO's forecasting record cannot be evaluated, strictly speaking, by comparing the forecasts to actual outcomes.) Because other forecasters usually use different budget policy assumptions, the CBO economic forecast is not necessarily a consensus or "middle-of-the-road" forecast. Nevertheless, the current short-term CBO forecast is not far from the current consensus forecast reported in the Blue Chip Indicators. CBO expects 3.2 percent real growth and 4.6 percent inflation (GNP deflator) in 1986, while the consensus calls for 2.7 percent and 4.6 percent respectively (see table below).

CBO AND CONSENSUS FORECASTS

(Calendar years)

| | 1985 | 1986 |
|---|---|---|
| Real GNP (percent change): | | |
| CBO | 3.5 | 3.2 |
| Blue Chip consensus | 3.7 | 2.7 |
| Inflation (percent change in GNP deflator): | | |
| CBO | 3.6 | 4.6 |
| Blue Chip consensus | 3.7 | 4.6 |
| Unemployment rate (percent): | | |
| CBO | 7.1 | 6.9 |
| Blue Chip consensus | 7.1 | 7.0 |
| Treasury bill rate (percent): | | |
| CBO | 8.3 | 8.7 |
| Blue Chip consensus | 8.4 | 8.7 |

SOURCES: Eggert Economic Enterprises Inc, Blue Chip Economic Indicators, February 10, 1985; Congressional Budget Office, The Economic and Budget Outlook: Fiscal Years 1986-1990, February 6, 1985.

CBO's economic projections for 1987-1990 are not forecasts at all. Instead, they are simple extrapolations based on the assumption that average economic growth from the recession trough at the end of 1982, through the end of 1990, should exactly match the average growth rate over comparable eight-year periods starting at previous recession troughs. Real interest rates, which did not have any strong trend in most of the postwar data, are assumed to remain constant from 1986 through 1990, though at very high levels compared with their history.

## INTEREST RATES

Question: The President's budget proposal assumes that interest rates will fall to 5 percent by 1990, while your forecast projects that inter-

est rates remain flat after 1986. What is the current real rate on 90-day T-bills? Is this spread high or low for the past few years? Moreover, if I understand correctly, the Administration is projecting inflation of 3.6 percent in 1989, and a T-bill rate of 5.1 percent. That means we are supposed to believe that real rates are expected to fall to 1.5 percent. Do you see any reason, short of an insanity plea, how the Administration can project the simultaneous occurrence of $180 billion deficits and real interest rates of 1.5 percent?

Answer: The real interest rate on T-bills is currently about 4½ percent. It is difficult to be precise about the number, since the real interest rate as understood by economists is the nominal rate less the inflation expected over the life of the bill: and we have no direct measure of that expectation. But assuming that people are broadly correct in their expectations, we get a number close to 4½ percent. This is about 1 point down from mid-1984 and well down from the peak of about 8½ percent reached in early 1982. In the decade before 1979, on the other hand, the real interest rate was frequently negative. During the 1960s it averaged 1.5 percent, and reached as high as 4 percent only once. Figure I-6, on Page 16 of our annual economic report, shows the history of the real rate.

The Administration projects deficits falling to $82 billion by 1990, under their policy assumptions and with their economic assumptions. About two-thirds of the difference between the CBO and Administration estimates of the deficit in 1990 with Administration policies can be traced to lower Administration interest rate forecasts. CBO believes that interest rates would be lower if deficits were lower, though not all economists would agree with this proposition. It is difficult to say by how much a $220 billion decline in the deficit—the difference between the CBO baseline budget projection and the Administration's projection for 1990—would reduce interest rates, but recent estimates by, for instance, Mr. Volcker suggest that the impact could be substantial.

## DEFICIT REDUCTION

Question: Many people would have us just sweep the deficit problem under the rug, at least for now. After all, we are in the middle of a solid economic recovery. I, for one, think that the time to face up to the problem is now. If we do, as history would suggest, have a recession before the decade is out, what would be a reasonable projection on deficits? If you had to pick a time to come to grips with the deficit problem, would you pick a time of economic prosperity—risking the onslaught of a recession—or would you wait for the crisis to hit—$300 billion deficts in the middle of the next recession ? If we can cut out a dollar of the deficit today, what kind of savings will that achieve, in terms of net interest saved, over the rest of the decade?

Answer: The economic assumptions underlying the CBO baseline budget projection, and the CBO analysis of the President's budget proposals, are consistent with a small recession occurring by the end of the decade. The economic growth assumptions are simply the average of experience in eight-year periods following six postwar recessions. Only one of these periods did not include a second recession, and two of them included two more. Thus the CBO deficit projections are, we believe, a reasonable estimate of deficits if there is a relatively small recession by the end of the decade. If there is a large recession, similar to that in 1973-1975, we estimate that the

deficit under the CBO current policy assumptions could be nearly $130 billion higher than our baseline estimate in 1990.

According to some theories, a very large, abrupt cut in the deficit would have an adverse impact on growth in the short run, so if we had the luxury of picking a time to cut the deficit it would seem wise to pick a period of relatively strong growth, such as the present. But since budgetary actions go into effect immediately, such careful selection of the time to cut deficits requires the ability to forecast with some accuracy the timing of recessions and recoveries: economists have not proven very good at that. In addition, there is a large penalty to delay: not only does the debt continue to grow, so that interest payments account for a growing proportion of the deficit, but also delay in resolving the issue makes for increased uncertainty, which itself could check growth. Businesses must make long-range decisions while recognizing the possibility that actions taken to close the deficit will fundamentally alter their business environment, and could make unprofitable investments that now seem attractive. Under these circumstances, not only is there an incentive to delay investment, but some investment could be misdirected. Thus the best time to cut the deficit is probably as soon as possible. Quick cuts in the deficit, even if they are relatively small, can have a large long-term payoff. A $1 reduction in the deficit other than interest payments, for the period from now through 1990, will result in an additional reduction of about 70 cents in the interest payable in 1990, under our assumptions. This arithmetic makes it even more a good idea to cut the deficit quickly.

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## NONDEPARTMENTAL WITNESSES

### CENTER FOR THE STUDY OF AMERICAN BUSINESS, WASHINGTON UNIVERSITY

### STATEMENT OF MURRAY L. WEIDENBAUM, DIRECTOR, CENTER FOR THE STUDY OF AMERICAN BUSINESS, WASHINGTON UNIVERSITY, ST. LOUIS

#### PROJECTED BUDGET DEFICIT TO 1990

Chairman HATFIELD. We will ask Professor Weidenbaum and Professor Schultze to come forward.

I would like to just make one observation, Senator Sasser, on your comment about the positive, affirmative statement made about the Congress by the CBO Director. I am sure that if we took an overall view of this problem, there is enough blame to go around for all branches of government, including the public and so forth.

But I do want to observe that it seems to me that as a Republican liberal socially and as a Republican fiscal conservative, I find it mindboggling to see a projection in 1990 when we would be at about the same level of deficit, $82 billion, that we had when we came into power in 1981. It is not good enough for my particular economic philosophy.

I am proud of the fact that when you take an overall view of spending requests and spending levels enacted in law by Congress, over a period of 40 years, the Congress is generally under the request level of Presidents', Republican and Democrat. And the Congress has been used as a whipping boy frequently, of course, in terms of being the big spenders and the Presidents being the fiscal conservatives.

That record isn't true. That record is not there. At the same time, I do think there is enough blame to go around and there is enough responsibility that we all have to pitch in to deal with this deficit. I for one want to see a balanced budget. I don't think it makes sense to talk about amending the Constitution for a balanced budget on one hand and then providing only for an $80 or $100 billion deficit at the end of 8 years of administration responsibility. I bear some of that responsibility as well. I just want to make that one observation.

Senator SASSER. If I might just make a brief response to the chairman, I couldn't agree with you more. My comment was not intended as a partisan comment.

Chairman HATFIELD. No, I know that.

Senator SASSER. As I am sure you know. I think the chairman said it well when he said if you look at the record over the past 50 years, the Congress has been at least as fiscally conservative as almost every Chief

Executive, Republican or Democrat. I know the chairman has worked hard to control spending in this committee.

Chairman HATFIELD. Thank you.

Gentlemen, it is a pleasure to have you. You always bring to us a provocative and challenging observation. We need it. We welcome it.

Professor Weidenbaum, do you want to start off and summarize or highlight your statement? I hope everyone reads it in toto. I like your style of communicating. [Laughter.]

Mr. WEIDENBAUM. Thank you, Mr. Chairman. It is a great pleasure to be back.

SEMBLANCE OF ORDER NECESSARY TO REDUCE DEFICITS

The annual budget debate has become a sad spectacle. We all know what has to be done, and neither Congress nor the White House is doing it. It is not a question of bringing an outlandish $200 billion deficit down to merely an outrageous $180 billion or a bloated $150 billion. It is a matter of restoring our country's finances to a semblance of order.

If anyone still doubts whether large budget deficits merit strong action to reduce them, they should take the peanut test. What would have happened if Jimmy Carter had propoesd the same $200 billion deficits?

There is enough blame to extend to both ends of Pennsylvania Avenue. It will take strong bipartisan support to get the deficit back merely to the double digit level of the 1970s.

Recent experience has shown us that $200 billion deficits do not cause the collapse of the American economy. Yet I am not of the school of thought that claims the effects, though severe, will only occur in the distant future. To be convinced that deficits matter, we need only to get out of our offices and look around.

AREAS HARDEST HIT BY HIGH INTEREST AND STRONG DOLLAR

I come from St. Louis, which is blessed by being both in the farm belt and in the so-called rust belt. We see which sectors are hardest hit by the high interest rates and the strong dollar: agriculture and old-line manufacturing.

CONGRESS HAS RESPONSIBILITY FOR CONTROLLING DEFICIT

You can fuel fascinating academic disputes by trying to measure precisely how much of our problems is due to deficits. The fact remains, curtailing the deficit is the basic responsibility of Congress and is the key economic lever you control directly.

To those who contend growth will cure our fiscal problems, I respond that the deficit is more likely to reach $300 billion during the 1980s than $100 billion. The next recession, which we cannot pinpoint or rule out, will push the deficit to a new peak. History argues for at least one more recession in the 1980s. It will take only an average downturn to accelerate spending and slow down revenue enough to produce a $300 billion deficit.

Our supply side friends tell us that we might as well take an extremely optimistic view because economists are not good at forecasting.

Yes, official forecasts of various administrations have usually overestimated growth, but occasionally they underestimated it. However, the prevailing private forecasts have been close to the mark. The average forecasting error in the past 8 years of real growth has been 1.2 percent.

PROPOSED FISCAL 1986 DEFICIT

But even on the basis of the optimistic projections in the January budget, and after the administration's proposed Spending cuts, the fiscal 1986 deficit is estimated at $178 billion. That is $3 billion higher than 1984 and only modestly below this year's.

It will take additional action to bring the deficit down significantly. Having participated in preparing the budget in several administrations, I have come away with the abiding belief that the correct response is to curb the many low-yield, postponable, and ineffective programs that remain in the budget.

The 1986 budget is a good news, bad news document. The good news is that some large fiscal bullets are being bitten. I endorse the President's proposals to slay or at least wound many sacred cows. The bad news is that deficit will remain, I am using the CBO numbers, in the neighborhood of $200 billion for the rest of the decade.

We need to get the budget under better control. The fiscal 1986 budget is a good start, but inadequate. Most of the attention is being given to reductions from fiscal 1985. That ignores the spending growth since 1980. In the past 4 years, many budget categories have mushroomed, and they are continuing to grow rapidly right now, in fiscal 1985.

GROWTH OF PROGRAM AREAS

Many program areas have grown much faster than the 30 percent rise in inflation. In this 5-year period, national defense is up 89 percent, foreign aid 60 percent, Social Security and Medicare 71 percent, farm subsidies 291 percent.

But even if all the proposed cuts are made, many programs will continue to be funded far more generously than in the previous administration. The proposed cutback in farm subsidies still leaves outlays in 1986 for farm subsidies 182 percent above 1980. Thus, when President Reagan says, "You ain't seen nothing yet," that statement should be applied to the effort to control spending.

The key is not to emphasize the hole in the donut, the painful cuts being proposed. Congress needs to examine the donut itself, the many doubtgul iteas of spending which remain. For every sacred cow being offered for slaughter, another is shielded from the budget knife.

UNEVENNESS OF BUDGET CONSTRAINT

Congress should consider the unevenness of budget constraint. The proposed eliminations in SBA, Export-Import Bank, et cetera, are severe and desirable. But what about the many other special interest activities?

In some lending programs the low interest rate is equivalent to forgiving half or more of the loan—66 percent in the case of Reclamation

credit. If the budget cuts are unfair, it is not because they cover too many programs but too few.

If it is desirable to reduce farm subsidies, why is the government authorizing new Corps of Engineers projects which will increase the amount of land on which surplus crops will be raised? Just using a realistic discount rate would show many of these projects cost far more than the benefits they generate.

I conclude with six specific proposals.

SLOW DOWN DEFENSE SPENDING

One, slow down defense spending. The target announced in the 1980 campaign, 5 percent a year increase plus allowance for inflation, has been, to put it kindly, overshot substantially. Our defense posture has not deteriorated since 1980. Large reductions in appropriations are needed to return the Pentagon's spending to the original trendline, 5 percent real annual growth from 1980. This implies holding defense spending in fiscal 1986 to $235 billion, a reduction of $43 billion from the budget.

The Pentagon's pursestrings need to be tightened. DOD is scheduled to end fiscal 1986 with $55 billion of unobligated balances. That exceeds the total obligated in the entire fiscal year by the Departments of Commerce, Education, Energy, Interior, Justice, Labor, State and Transportation combined. There will be enough left over to finance the Congress and the Judiciary, the Executive Office, EPA, GSA and SBA, and a billion dollars of miscellaneous activities. I think that indicates the generous cushion in military budgets.

But the most harmful effect of the run-away military budget is the erosion of public support. In the dangerous world in which we live it troubles me to see the sharp shift in sentiment over the last 4 years. At the beginning of this decade, public opinion polls consistently showed strong support for higher military budgets. In 1980, 56 percent of the public thought not enough was being spent on defense.

The same polls now show strong sentiment for cutting defense. In 1984, only 17 percent believed the United States is spending too little on defense. In early 1985, that figure is down to 9 percent, with 88 percent favoring no increase or even a reduced military budget.

We cannot balance the budget simply by reducing the military, but substantial defense cuts are essential in any successful effort to reduce overall spending. Otherwise civilian program supporters can properly raise the fairness issue.

ELIMINATE COLAS IN ENTITLEMENTS

Point two, eliminate the COLAs in entitlements. The public has an erroneous conception of "social insurance." Social Security recipients believe they are "entitled" to their monthly checks because they paid for them during their working years. That is just not true. Most people on Social Security have long since gotten back all they paid in—plus employer contributions and interest. The difference is made up by those now working. That is the economic equivalent of welfare.

Retroactive benefit increases for COLAs are not common in private insurance. The beneficiaries did not pay for them. Thus, nobody is "entitled" to them. The Congress should begin to reduce and then to phase out automatic annual cost-of-living benefit increases.

APPLICATION OF INSURANCE PRINCIPLES TO MEDICARE

Three, apply some insurance principles to Medicare. Every automobile insurance policy has a deductible in it to avoid overwhelming the system with minor claims. The same approach should be used in health insurance, especially Medicare. The use of cost-sharing would force hospitals and doctors to think of the patient and not big government when they incur costs and make changes.

FEDERAL LENDING PROGRAMS

Point four, eliminate the double whammy in Federal lending programs. These activities are set up because some people can't get private credit. To grant that aid is a political judgment properly made by Congress. The catch is these credit programs loan out money at interest rates much lower than private lenders—lower even than the Treasury pays for the money.

These interest rate subsidies encourage people to apply for government loans. Federal programs should charge the same interest rates as the Treasury pays. Ideally, they should match the going rate in competitive financial markets. That would really reduce the demand for Federal loans.

SUBSIDIES TO BUSINESS AND FARMERS

Point five, phase out subsidies to businesses and farmers. We must face the painful fact that the average taxpayer has a lower income than beneficiaries of most programs aiding agriculture and industry. The small family farmer may certainly be hurt, but he or she does not receive much of these large subsidies. Similarly, most businesses do not benefit from the government's programs. Getting interest rates down via budget cuts would do more good for farmers and businesses alike.

Finally, do not ignore other areas where spending continues to grow rapidly. In the supposedly barebones budget for fiscal 1986, foreign military aid is up 215 percent over 1980. Civilian space support is up 148 percent. Housing assistance is up 124 percent. USIA is up 95 percent, and the State Department 80 percent.

I learned in my days in the old budget bureau "good budgeting is the uniform distribution of dissatisfaction." I am urging Congress to make tough and unpopular decisions. But the meter is running. Interest payments are mounting steadily. Delay means choosing in the future between even larger and tougher spending cuts and substantial and more unpopular tax increases. The only answer to a budget fundamentally out of control is to control it now.

Thank you.

PREPARED STATEMENT

Chairman HATFIELD. Thank you, Professor Weidenbaum. Your prepared statement will be inserted at this point in the record.

[The statement follows:]

PREPARED STATEMENT OF MURRAY L. WEIDENBAUM
DIRECTOR, CENTER FOR THE STUDY OF AMERICAN BUSINESS
WASHINGTON UNIVERSITY IN ST. LOUIS

The annual budget debate has become a sad spectacle. We all know what has to be done -- and neither the Congress nor the White House is doing it. It is not a question of bringing an outlandish $200 billion deficit down to merely an outrageous $180 billion or a bloated $150 billion annual level. It is a matter of restoring our country's finances to some semblance of order.

If anyone has any doubt as to whether those large budget deficits merit strong action to reduce them, they should take what I call the peanut test: if Jimmy Carter had proposed the same $200 billion deficits, what do you think would have happened? Why, he would have been tarred and feathered and run out of town on a rail.

Are we so partisan as to believe that Democratic deficits are evil but Republican deficits of the same magnitude are benign? Indeed, there is enough blame to extend to both sides of the political aisle and to both ends of Pennsylvania Avenue. And it will take strong bipartisan support to get the deficit back merely to the double digit level of the 1970s.

To be sure, recent experience has shown us that $200 billion deficits do not spell the collapse of the American economy. Yet I am not of the school of thought that claims the effects, albeit severe, will only occur in the distant future. To be convinced that deficits do matter, we need only to get out of our offices and look around. We know which sectors have been hardest hit by the resultant high interest rates and strong dollar: (1) agriculture, the most capital-intensive part of the economy, and (2) traditional durable goods industries, which find it difficult to compete with foreign firms that benefit from the low exchange rate of their local currencies.

I concede that you can fuel lots of fascinating academic disputes by trying to measure precisely how much of our economic problems is due to those

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Note: Dr. Weidenbaum is Director of the Center for the Study of American Business at Washington University in St. Louis. The views expressed are strictly personal.

budget deficits. The key fact remains, however, that curtailing the deficit is the basic responsibility of the Congress -- it is the key economic lever that you control directly.

Economic Growth and Deficits

To those who contend that economic growth will cure our fiscal problems, I respond that the deficit is more likely to reach $300 billion during the 1980s, than $100 billion. The next recession -- which we can neither pinpoint nor rule out -- will push the budget deficit to a new peak. History argues for at least one more recession in the 1980s. It will only take a downturn of average duration to accelerate government spending and slow down revenue sufficiently to produce a $300 billion deficit.

Our supply side friends tell us that we might as well take an extremely optimistic view because economists are not very good at forecasting the future. The official forecasts, of various administrations, have been somewhat short of perfection, usually substantially overestimating the rate of economic growth, but occasionally underestimating it. However, the prevailing forecasts of experienced private analysts have been relatively close to the mark. As Table 1 shows, the average forecasting errors in the past eight years has been a modest 1.2 percent.

In the Fall of 1982, for example, private forecasters projected a 3.2 percent rate of economic growth for 1983. The actual figure was 3.7 percent -- not too far from the mark. In the Fall of 1983, most private forecasters projected an acceleration in the pace of the recovery in 1984; the Blue Chip figure was 5.1 percent. The speed up occurred, even more rapidly, at a rate well over 6 percent. Again, the forecasts were a a good indication of the future direction, but surely did not achieve pinpoint accuracy.

Today, most experienced forecasters are projecting a slowdown in the pace of economic growth, to 3.5 percent. It is premature to evaluate that number, but the direction of change certainly seems reasonable. In any event, the accuracy of recent predictions provides no basis for requiring economic forecasters to rend their garments, don sackcloth and ashes, and recite the Book of Lamentations -- as some critics suggest.

Even on the basis of the more optimistic projections contained in the

January budget -- and after all the spending cuts proposed by the Administration -- the deficit for fiscal 1986 is estimated at $178 billion. That is $3 billion higher than the 1984 level and only modestly below the total anticipated for the current year.

Thus, it will take additional action to bring those deficits down significantly. Having participated closely in the preparation of the budget in several administrations, I have come away with the abiding belief that the correct response is not to increase the burden on the taxpayer, but rather to curb the many low-yield, postponable, and ineffective programs that remain in the budget.

Table 1

COMPARISON OF BLUE CHIP PROJECTIONS AND ACTUAL CHANGE IN REAL GNP

| Annual Forecast | Percent Change in Real GNP | | |
|---|---|---|---|
| | BLUE CHIP Forecast | Actual | Forecast Error |
| 1977 | 4.9% | 5.5% | -0.6% |
| 1978 | 4.3 | 5.0 | -0.7 |
| 1979 | 2.7 | 2.8 | -0.1 |
| 1980 | -0.2 | -0.3 | +0.1 |
| 1981 | 0.9 | 2.5 | -1.6 |
| 1982 | 2.2 | -2.1 | +4.3 |
| 1983 | 3.2 | 3.7 | -0.5 |
| 1984 | 5.1 | 6.8 | -1.7 |
| Average Absolute Error | | | 1.2% |

Note: Each month the Blue Chip panel of over 45 professional economic forecasters provides a concensus forecast for the year ahead. The forecast made in the month of October of the prior year was selected since it is typical of the starting point for company planning and financial and sales budgets for the year ahead.

Source: Blue Chip Economic Indicators

Fiscal 1986 Spending

Let us turn to the fiscal 1986 budget. The new federal budget is a good news, bad news document. The good news is that, finally, some large fiscal bullets are being bitten. President Reagan is proposing real, substantial cuts in government spending. The bad news is that the federal deficit will remain in the neighborhood of $200 billion a year for the rest of the decade of the 1980s. Remember, that pessimistic finding is grounded on two optimistic assumptions: (1) upbeat but reasonable forecasts of continued economic growth for the next several years and (2) the approval by Congress of $50 billion of proposed cuts.

We need to get the budget under better control. Nobody's first choice is to raise taxes. A comprehensive round of outlay reductions is required. The fiscal 1986 budget, although a good start, is inadequate.

Most of the attention is being given to the proposed reductions from the fiscal 1985 levels of spending. That ignores the spending growth that has taken place since 1980. In the past four years, many budget categories have mushroomed, and they are continuing to grow rapidly right now, in fiscal 1985.

Table 2 shows the change in outlays for the major budget categories from fiscal 1980 to 1985. Many program areas have grown much faster than the 30 percent rise in rate of inflation since 1980. In this five year period, national defense outlays are up 89 percent, foreign aid and other international programs are up 60 percent, social security and medicare are up 71 percent, and farm programs (mainly subsidies) are up 291 percent.

I find little to criticize in the specifics of the proposed budget cuts for 1986, as far as they go. I strongly endorse these proposals to slay or at least wound many sacred cows.

But it is also clear that -- even if all the proposed cuts are approved -- expenditures for many programs will continue to be far above the amounts devoted to those purposes at the beginning of this decade (see Table 3). For example, the proposed "cutback" in farm subsidies would still leave annual outlays for that program at a level 182 percent above 1980 -- far more than necessary to offset the effects of inflation.

Table 2

CHANGE IN FEDERAL OUTLAYS, BY FUNCTION, 1980-1985
(Fiscal Years, Dollars in millions)

| Function | 1980 | 1985 Estimate | Dollar Change 1980-1985 | Percent Change 1980-1985 |
|---|---|---|---|---|
| National Defense | $134.0 | $253.8 | $119.8 | 89 |
| International Affairs | 10.8 | 17.3 | 6.5 | 60 |
| Science and Technology | 5.7 | 8.8 | 3.1 | 54 |
| Energy | 6.3 | 3.0 | (3.3) | (53) |
| Resources and Environment | 13.8 | 13.0 | (.8) | (6) |
| Agriculture | 4.9 | 19.0 | 14.1 | 291 |
| Commerce and Housing | 7.8 | 2.8 | (5.0) | (64) |
| Transportation | 21.1 | 27.0 | 5.9 | 28 |
| Regional Development | 10.1 | 7.9 | (2.2) | (22) |
| Education and Employment | 30.7 | 30.4 | (.3) | (1) |
| Health | 23.1 | 33.9 | 10.8 | (46) |
| Social Security and Medicare | 150.6 | 257.4 | 106.8 | 71 |
| Income Security | 86.4 | 127.3 | 40.9 | 47 |
| Veterans | 21.2 | 26.9 | 5.7 | 27 |
| Justice | 4.6 | 6.7 | 2.1 | 46 |
| General Government | 4.3 | 5.8 | 1.5 | 36 |
| General Fiscal Assistance | 8.6 | 6.6 | (2.0) | (24) |
| Interest | 52.5 | 130.4 | 77.9 | 148 |
| Offsetting Receipts | (19.9) | (32.3) | (12.4) | (62) |
| TOTAL | $576.7 | $945.6 | $369.1 | 64 |

Note: Detail may not add to totals shown due to rounding.

Source: Statistical Appendix

Thus, when President Reagan says, "You ain't seen nothing yet," that statement could properly be applied to the current effort to control federal expenditures.

In expanding the current focus of budget cutting, the Congress should consider the unevenness of budget restraint to date. The proposed reductions or eliminations in SBA, Export-Import Bank, etc. are severe -- although, in my view, desirable. But if these special-interest programs are to be curtailed,

Table 3

EXPANDING BUDGET CATEGORIES
Fiscal Years 1980 - 1986

| Category of Expenditure | Percent Change 1980-86 |
|---|---|
| Items rising in real terms (over 35.7 percent) | |
| Foreign military aid | 216 |
| Agriculture (total) | 182 |
| Public debt interest | 166 |
| Housing assistance | 124 |
| National defense (total) | 113 |
| Foreign information activities | 95 |
| Correctional activities | 84 |
| Conduct of foreign affairs | 80 |
| Social security and medicare (total) | 79 |
| Science and technology (total) | 64 |
| Law enforcement | 61 |
| Health care | 57 |
| Federal employee retirement | 56 |
| Medical care | 53 |
| Litigation and judicial | 53 |
| Health research | 51 |
| Foreign economic aid | 46 |
| Other commerce | 42 |
| Higher education | 41 |
| Legislative | 36 |
| Items rising in nominal terms (less than 35.7 percent) | |
| Food and nutrition | 30 |
| Veterans income security | 30 |
| Other income security | 27 |
| Central fiscal | 26 |
| Other labor services | 23 |
| Other veterans | 23 |
| Transportation | 22 |
| Other resources and environment | 18 |
| Executive direction | 16 |
| Social services | 12 |
| Elementary and secondary education | 11 |
| General retirement insurance | 10 |
| Occupational health and safety | 5 |

Note: The cumulative inflation rate from 1980 to 1986 was 35.7 percent, based on the GNP deflator.

Source: Statistical Appendix

what about the many other special-interest activities that have survived budget review?

For example, in some federal lending programs the interest rate is so low that it is equivalent to forgiving half or more of the loan -- 66 percent in the case of Bureau of Reclamation credit. If the budget cuts are considered unfair, it is not because they cover too many programs, but too few.

If it is desirable to reduce farm subsidies -- and I believe it is -- why is the Federal Government continuing to authorize new Corps of Engineers projects which will increase the amount of land on which surplus crops will be raised? Why phase out general revenue sharing -- which comes with few strings attached -- but only make modest reductions in categorical grants to states and localities? Can it be that the federal agencies, when we get down to the wire, are more concerned with keeping control over state and local governments than with reducing the deficit?

The key to dealing with the deficit problem is not to emphasize the hole in the donut -- the painful cuts that are being proposed. Rather, policymakers need to carefully examine the donut itself, the many doubtful items of federal expenditure which remain in the budget. For every sacred cow that is now being offered for slaughter, another remains shielded from the federal budget knife. The best way to reduce the deficit -- and to lay the foundation for responsible tax reform in the years ahead -- is to carry through that nececessary pruning of federal spending programs.

## A Specific Plan for Budget Cutting

In conclusion, here are five specific proposals to achieve comprehensive budget cuts.

1. Slow down the rapid pace of defense spending. The target for defense spending announced in the 1980 campaign -- 5 percent a year increase plus allowance for proposed inflation -- has been overshot substantially. Surely our defense posture has not deteriorated since 1980. Large reductions in new appropriations are needed to return the Pentagon's spending level to the original trendline -- 5 percent real annual growth from 1980. Rather than the $277.5 billion of outlays projected for fiscal 1986, this would imply holding to $234.6 billion, a reduction of $42.9 billion.

The Pentagon's purse strings need to be tightened in order to serve the goal of good management of federal money. The Department of Defense is scheduled to end fiscal 1986 with over $55 billion of unused appropriations. The technical term is "unobligated balances."

That sum is more than the total amount that will be used (committed or "obligated") in the entire fiscal year by the Departments of Commerce, Education, Energy, Interior, Justice, Labor, State, and Transportation. There will be enough left over to finance all of the operations of the Congress, the Judiciary, the Executive Office of the President, the Environmental Protection Agency, the General Services Administration, and the Small Business Administration and over $1 billion of miscellaneous activities. This is a clear indicator of the generous cushion in military budgets.

The most harmful effect of the runaway military budget is not the adverse economic and financial results, such as higher interest rates. Instead, it is the erosion of public support for the defense establishment. In the dangerous world in which we live, it troubles me to see the sharp shift in sentiment on this matter over the last four years.

At the beginning of this decade, public opinion polls consistently showed strong support for increasing the military budget. The National Opinion Research Center reported that, in 1980, 56 percent of the public thought that not enough money was being spent on defense.

That attitude has changed dramatically. The same poll shows a strong shift in sentiment toward cutting defense spending. In 1984, only 17 percent of the American public believed that the United States is spending too little on defense. A Harris poll in early 1985 has that figure down to 9 percent. This compares to 88 percent who favor no increase at all or even a reduced military budget.

Secretary of Defense Caspar Weinberger loves to remind us that we cannot balance the federal budget simply by reducing military outlays. He is right, but substantial defense cuts are an essential ingredient of any successful effort to reduce overall federal spending. Otherwise, supporters of civilian programs that are being cut can properly raise the "fairness" issue and voter support for defense spending will continue to erode.

2. Reduce -- or eliminate -- the COLAs in entitlement programs. It is time to acknowledge that the public has an erroneous conception of "social insurance" programs. Social security recipients believe they are "entitled" to their monthly checks because they paid for them during their working years. The truth of the matter is that most of the people on the social security rolls have long since gotten back all they paid in -- plus employer contributions and interest. The difference is made up by the generation now working. Is that the economic equivalent of welfare? Yes, it is.

Retroactive benefit increases for cost-of-living allowances (COLAs) are not part of most private insurance systems. Nobody paid for them or is "entitled" to them. The Congress should begin to reduce and then to phase out automatic annual cost-of-living benefit increases. Such action would also increase public support for continued actions against inflation.

3. Eliminate the double whammy in federal lending programs. The demand for federal credit programs continues to grow rapidly. These activities have been typically set up because some people are not deemed credit worthy by private financial institutions. To grant that type of aid is a political judgment properly made by Congress. The catch is that these credit programs almost always loan out the government's money at interest rates much lower than private lenders charge -- lower even than the Treasury pays for the money in the first place.

These interest rate subsidies are more than an expensive extra "goody." They encourage people to get government loans, rather than to look to private credit markets or to their own resources. As a minimum, federal credit programs should charge the same interest rates as the Treasury pays. Ideally, they should match the going rate in competitive financial markets. That would really reduce the demand for federal loans.

4. Phase out subsidies to businesses and farmers. The average taxpayer has a lower income than the beneficiaries of most federal programs aiding agriculture and industry. The small family farmer does not receive much of these large subsidies. It is hard to justify these outlays when we learn that they result in such inequities as the American consumer paying 20 cents for a pound of sugar when the world price is less than a nickel.

Similarly, most businesses -- small and large -- do not benefit from the government's assistance to a lucky few firms. Getting interest rates down via budget cuts would do the most good for farmers and business firms alike.

5. Do not ignore the many other areas where spending continues to grow rapidly. For example, in the supposedly bare bones budget for fiscal 1986, outlays for foreign military aid are up 215 percent over 1980. Civilian space support activities are up 148 percent. The highly-publicized proposed cuts notwithstanding, housing assistance is up 124 percent. USIA and other foreign information activities are budgeted for a 95 percent rise over 1980, and the State Department for an 80 percent increase. The appendix to this statement contains a comprehensive tabulation of budget trends since 1980 and is a good guide to additional budget cutting.

Where should the Congress stop? An adequate and comprehensive budget restraint effort should be based on the old maxim, "Good budgeting is the uniform distribution of dissatisfaction." Not enough of the spending agencies and their supporters are dissatisfied.

I know that I am urging the Congress to make many tough and even initially unpopular decisions. But it is the Congress that ultimately will have to choose between even larger spending cuts or substantial tax increases. Every examination of the soft spots in the budget shows that they do not deserve being funded by increasing the tax burden on the American public. The only satisfactory answer to a budget that is fundamentally out of control is to control it!

BROOKINGS INSTITUTION

## STATEMENT OF CHARLES L. SCHULTZE, SENIOR FELLOW, BROOKINGS INSTITUTION

### EFFECT OF DEFICIT ON U.S. ECONOMY

Chairman HATFIELD. Professor Schultze, we have heard from you many times over the years. We always appreciate what you have to say. We are anxious to hear you today.

Mr. SCHULTZE. Thank you, Mr. Chairman, and members of the committee, for asking me to testify. I will read what I have but abridge it liberally as I go.

Chairman HATFIELD. Thank you.

Mr. SCHULTZE. Let me summarize the two points I want to make in advance.

First, the damage done to the American economy by a continuation of the huge budget deficit now in prospect is and will be subtle, indirect and gradual, not obvious, direct and immediate. With a little bit of luck, quite likely we can continue to enjoy moderate economic growth and low inflation for some time to come, even if nothing is done. A few particular sectors are being hurt now.

The damage done by the deficits will come in the form of gradual changes that will slowly erode our living standards: gradually falling productivity growth, growing payments to foreigners to service our mounting foreign debt, and unnecessarily high taxes to pay interest on the swelling Federal debt.

Ironically, the worst thing about the budget deficits is precisely they will not produce an obvious crises. If they did, you could probably get the necessary consensus to eliminate them.

The second point, a hard assessment of budget numbers and political reality argues that any successful large-scale assault on the deficit must include all major elements in the budget—defense spending, Social Security, and taxes—as well as the other civilian programs of the Government.

You know the numbers on the size of the deficit. I need not spend any time on it. The basic proposition is if nothing is done about the budget deficit, on reasonable estimates, Federal borrowing will remain at some 5 to 5.5 percent of the GNP out into the indefinite future as far as the eye can see—this in a country whose net savings outside the Federal sector only amounts to 8 to 9 percent of GNP.

In the next several years, and probably for longer, the budget deficits are not likely to bring on either inflation or recession.

### FEDERAL RESERVE POLICY

To demonstrate this, I think it is necessary to start with a few words about the policy of the Federal Reserve. The Fed, I think, now has two principal objectives. First, faced with the huge and continuing pump-priming stimulus from the Federal budget deficit, the Fed's principal objective is an anti-inflation one—to keep a lid on the growth of national spending and output. It will do whatever it feels it has to do by way of tight money and high interest rates to prevent an excessively

rapid growth from overheating the economy and generating new inflation.

But the Fed also has no desire to see another recession. Unlike 1981 and 1982, the Fed will not deliberately, I think, put this economy through the wringer of another recession in order to get inflation down further. So long as inflationary pressures remain moderate, as they now show signs of doing, the Fed will not stand by and watch the economy go into recession.

If it appears that monetary restraint has gone too far, that economic growth is slowing too much, as apparently happened last fall, the Fed will move to ease monetary policy, lower interest rates and correct its mistakes, as it did last fall and early winter.

Real interest rates in this country are still so high even after the recent easing that the Fed has very large scope to use monetary policy to correct any mistake or offset any softening in the economy. More so than usually, the Fed is now in a good position to provide countryrecessionary assistance for the economy, should that be necessary to avert a recession.

RECESSION AND INFLATION NOT PREDICTED FOR NEAR FUTURE

The upshot of all of this, Mr. Chairman, is that the large Federal budget deficits, even if left unattended, aren't likely in the next several years to generate recession or inflation.

DAMAGE OF U.S. ECONOMIC STRUCTURE POSSIBLE

Nevertheless, deficits will have very damaging, long-term consequences for the U.S. economy. They will damage its structure.

What kind of damages are those? Well, let's start with looking at the last 2 years. For the past several years we have been witnessing and will continue to witness a continuing clash of two opposing forces—a large upward stimulus to some sectors of the economy from the pump-priming activities of a huge Federal budget deficit and substantial restraint on other sectors of the economy from the Fed's high interest rates.

Another way of looking at the same phenomenon is the Federal Government is borrowing 5 to 5.5 percent of GNP. Given the Federal Reserve's objective of preventing excessively rapid recovery, something else had to give. Five percent of GNP had to be squeezed out of other interest-sensitive activities by the high interest rates. This change in economic structure is going to have damaging, long-term consequences for the economy.

There are only three possible ways by which higher interest rates can crowd out private activity to make room for Federal borrowing of 5 percent of GNP. You have to get rid of 5 percent. Where is it going to come from? Three routes.

First, an increase in private saving to finance the extra Federal borrowing or, second, a decrease in interest-sensitive private spending—lower housing construction, lower business investment or, third, an inflow of saving from abroad. Lower exports and higher imports lead-

TRENDS IN BUDGET OUTLAYS, BY FUNCTION, 1980-86,
(Fiscal years, dollars in millions)

| Function and Subfunction | 1980 | 1985 estimate | Percent Change 1980 - 1985 | 1986 estimate | Percent Change 1980 - 1986 |
|---|---|---|---|---|---|
| National Defense | | | | | |
| Military personnel | $ 40,897 | $ 67,546 | 65.2% | $ 72,798 | 78.0% |
| Operations & maintenance | 44,770 | 74,569 | 66.6 | 79,648 | 77.9 |
| Procurement | 29,021 | 69,706 | 140.2 | 83,045 | 186.2 |
| Research, development, etc. | 13,127 | 27,786 | 111.7 | 33,988 | 158.9 |
| Construction | 2,450 | 4,209 | 71.8 | 5,296 | 116.2 |
| Family housing, etc. | 711 | 2,484 | 249.4 | 2,726 | 283.4 |
| Subtotal, DOD | $ 130,976 | $ 245,300 | 87.3 | $ 277,500 | 111.9 |
| Atomic energy defense activities | 2,878 | 6,991 | 142.9 | 7,700 | 167.5 |
| Defense-related activities | 142 | 533 | 275.4 | 464 | 226.8 |
| Total | $ 133,995 | $ 253,825 | 89.4 | $ 285,664 | 113.2 |
| International Affairs | | | | | |
| Foreign economic aid | $ 3,630 | $ 5,528 | 52.3 | $ 5,283 | 45.5 |
| Foreign military aid | 2,831 | 7,837 | 176.8 | 8,931 | 215.5 |
| Conduct of foreign affairs | 1,366 | 2,152 | 57.5 | 2,454 | 79.6 |
| Foreign information activities | 534 | 941 | 76.2 | 1,041 | 94.9 |
| International finance | 2,425 | 790 | (67.4) | 364 | (84.9) |
| Total | $ 10,786 | $ 17,248 | 59.9 | $ 18,073 | 67.6 |
| Science and Technology | | | | | |
| General science & basic research | $ 1,381 | $ 2,116 | 53.2 | $ 2,237 | 62.0 |
| Space flight | 2,594 | 3,914 | 50.9 | 4,004 | 54.4 |
| Space technology | 1,346 | 1,890 | 40.4 | 2,144 | 59.3 |
| Space support | 405 | 886 | 118.8 | 1,007 | 148.6 |
| Total | $ 5,725 | $ 8,807 | 53.8 | $ 9,392 | 64.1 |

| Function and Subfunction | 1980 | 1985 estimate | Percent Change 1980 - 1985 | 1986 estimate | Percent Change 1980 - 1986 |
|---|---|---|---|---|---|
| Energy | | | | | |
| Supply | $ 4,520 | $ 1,374 | (69.6) | $ 593 | (86.9) |
| Conservation | 568 | 545 | (4.0) | 381 | (32.9) |
| Emergencies | 342 | 276 | (19.3) | 236 | (30.9) |
| Regulation & Policy | 882 | 764 | (13.4) | 736 | (16.6) |
| Total | $ 6,312 | $ 2,959 | (53.1) | $ 1,946 | (69.2) |
| Resources and Environment | | | | | |
| Water resources | $ 4,223 | $ 4,293 | 1.7% | $ 3,566 | (15.6) |
| Land management | 1,043 | 979 | (6.1) | 719 | (31.0) |
| Recreation | 1,677 | 1,622 | (3.3) | 1,361 | (18.8) |
| Pollution control | 5,510 | 4,387 | (20.4) | 4,579 | (16.9) |
| Other | 1,405 | 1,744 | 24.1 | 1,660 | 18.1 |
| Total | $ 13,858 | $ 13,024 | (6.0) | $ 11,884 | (14.2) |
| Agriculture | | | | | |
| Farm income stabilization | $ 3,459 | $ 17,169 | 396.4 | $ 12,021 | 247.5 |
| Research and services | 1,398 | 1,821 | 30.3 | 1,691 | 20.9 |
| Total | $ 4,857 | $ 18,990 | 291.0 | $ 13,713 | 182.3 |
| Commerce and Housing | | | | | |
| Mortgage credit & deposit insurance | $ 3,696 | $ (156) | - | $ (533) | - |
| Postal service | 1,677 | 1,041 | (37.9) | 39 | (97.7) |
| Other commerce | 2,415 | 1,947 | (19.4) | 3,437 | 42.3 |
| Total | $ 7,788 | $ 2,831 | (63.6) | $ 2,943 | (62.2) |
| Transportation | | | | | |
| Ground | $ 15,077 | $ 18,738 | 24.6 | $ 17,775 | 17.9 |
| Air | 3,723 | 4,966 | 33.4 | 5,175 | 39.0 |
| Water | 2,229 | 3,176 | 42.5 | 2,792 | 25.3 |
| Other | 104 | 123 | 18.3 | 127 | 22.1 |
| Total | $ 21,132 | $ 27,003 | 27.8 | $ 25,869 | 22.4 |

| Function and Subfunction | 1980 | 1985 estimate | Percent Change 1980 - 1985 | 1986 estimate | Percent Change 1980 - 1986 |
|---|---|---|---|---|---|
| Regional Development | | | | | |
| Community development | $ 4,878 | $ 4,819 | (1.2) | $ 4,592 | (5.9) |
| Regional development | 3,152 | 2,707 | (14.1) | 2,334 | (25.9) |
| Disaster relief | 2,043 | 326 | (84.0) | (84) | - |
| Total | $ 10,072 | $ 7,852 | (22.0) | $ 6,841 | (32.1) |
| Education and Employment | | | | | |
| Elementary & secondary education | $ 6,908 | $ 7,661 | 10.9 | $ 7,670 | 11.0 |
| Higher education | 5,656 | 8,506 | 50.4 | 7,959 | 40.7 |
| Research & general education | 1,197 | 1,225 | 2.3 | 1,187 | (.8) |
| Training & employment | 10,345 | 5,298 | (48.8) | 4,931 | (52.3) |
| Other labor services | 551 | 711 | 29.0 | 679 | 23.2 |
| Social services | 6,116 | 7,032 | 14.9 | 6,863 | 12.2 |
| Total | $ 30,773 | $ 30,434 | (1.1) | $ 29,288 | (4.8) |
| Health | | | | | |
| Health care | $ 17,981 | $ 27,248 | 51.5 | $ 28,212 | 56.9 |
| Research | 3,442 | 4,961 | 44.1 | 5,204 | 51.2 |
| Education & training | 719 | 478 | (33.5) | 455 | (36.7) |
| Occupational health & safety | 1,006 | 1,196 | 18.9 | 1,059 | 5.3 |
| Total | $ 23,148 | $ 33,883 | 46.4 | 34,930 | 50.9 |
| Social Security and Medicare | | | | | |
| Social security | $118,548 | $191,107 | 61.2 | $202,245 | 70.6 |
| Medicare | 32,090 | 66,256 | 106.5 | 67,158 | 109.3 |
| Total | $150,638 | $257,363 | 70.8 | $269,404 | 78.8 |

| Function and Subfunction | 1980 | 1985 estimate | Percent Change 1980 - 1985 | 1986 estimate | Percent Change 1980 - 1986 |
|---|---|---|---|---|---|
| Income Security | | | | | |
| General retirement insurance | $ 5,082 | $ 5,504 | 8.3 | $ 5,580 | 9.8 |
| Federal employee retirement | 26,594 | 38,641 | 45.3 | 41,518 | 56.1 |
| Unemployment compensation | 18,023 | 16,780 | (6.9) | 16,294 | (9.6) |
| Housing assistance | 5,514 | 25,387 | 360.4 | 12,339 | 123.8 |
| Food and nutrition | 14,016 | 18,664 | 33.2 | 18,268 | 30.3 |
| Other | 17,191 | 22,296 | 29.7 | 21,806 | 26.8 |
| Total | $ 86,420 | $127,272 | 47.3 | $115,804 | 34.0 |
| Veterans | | | | | |
| Income security | $ 11,688 | $ 14,754 | 26.2 | $ 15,135 | 29.5 |
| Education & training | 2,342 | 1,295 | (44.7) | 1,110 | (52.6) |
| Medical care | 6,515 | 9,621 | 47.7 | 9,994 | 53.4 |
| Housing | (23) | 358 | - | (288) | - |
| Other | 665 | 823 | 23.8 | 817 | 22.9 |
| Total | $ 21,185 | $ 26,850 | 26.7 | $ 26,769 | 26.4 |
| Justice | | | | | |
| Law enforcement | $ 2,237 | $ 3,681 | 64.6 | $ 3,610 | 61.4 |
| Litigation and judicial | 1,347 | 2,192 | 62.7 | 2,066 | 53.4 |
| Correctional activities | 342 | 580 | 69.6 | 632 | 84.5 |
| Criminal justice aid | 656 | 233 | (64.5) | 280 | (57.3) |
| Total | $ 4,582 | $ 6,686 | 45.9 | $ 6,587 | 43.8 |
| General Government | | | | | |
| Legislative | $ 1,038 | $ 1,464 | 41.0 | $ 1,417 | 36.5 |
| Executive direction | 97 | 119 | 22.7 | 112 | 15.5 |
| Central fiscal | 2,465 | 3,533 | 43.3 | 3,105 | 25.9 |
| Central property and records | 287 | 381 | 32.8 | 186 | (35.2) |
| Central personnel | 154 | 153 | (.6) | 143 | (7.1) |
| Other | 560 | 586 | 4.6 | 390 | (30.4) |
| Offsetting receipts | (351) | (448) | (27.6) | (504) | (43.6) |
| Total | $ 4,251 | $ 5,787 | 36.1 | $ 4,850 | 14.1 |

| Function and Subfunction | 1980 | 1985 estimate | Percent Change 1980 - 1985 | 1986 estimate | Percent Change 1980 - 1986 |
|---|---|---|---|---|---|
| General Fiscal Assistance | | | | | |
| Revenue sharing | $ 6,835 | $ 4,617 | (32.5) | $ 1,168 | (82.9) |
| Other | 1,747 | 1,934 | 10.7 | 1,629 | (6.8) |
| Total | $ 8,582 | $ 6,552 | (23.7) | $ 2,797 | (67.4) |
| Interest | | | | | |
| Public debt | $ 74,781 | $180,295 | 141.1 | $198,805 | 165.8 |
| Trust funds | (12,045) | (25,554) | (112.2) | (29,149) | (142.0) |
| Other | (10,224) | (24,315) | (137.8) | (27,106) | (165.1) |
| Total | $ 52,512 | $130,426 | 148.4 | $142,550 | 171.5 |
| Allowances | - | $ 1,131 | - | $ 399 | - |
| Offsetting Receipts | | | | | |
| Employee retirement | ($15,842) | ($26,994) | (70.4) | ($28,961) | (82.8) |
| Outer Continental Shelf | (4,101) | (5,302) | (29.3) | (7,317) | (78.4) |
| Sale of Conrail | - | - | - | (1,200) | - |
| Total | ($19,942) | ($32,296) | (61.9) | ($37,478) | (87.9) |
| GRAND TOTAL | $576,675 | $946,526 | 64.2 | $972,224 | 68.6 |

Note: Detail may not add to totals shown due to rounding.

Source: Compiled from Budget of the United States Government, Fiscal Year 1986.

ing into a higher inflow of foreign capital and savings into the United States.

The surprising fact about the last 2 years is that most of the consequences of combining large deficits and tight money have been felt in the foreign sector. That is the third route I mentioned earlier.

FACTOR OF SMALL INCREASE IN SAVINGS

We have had little increase in savings as a share of GNP. We are not likely to have. Altogether, an optimistic assumption would tell us that it is very unlikely that any more than one-half to 1 percent of the 5 percent of GNP that has to be absorbed by Federal borrowing can come from increased saving.

There has been some reduction in housing construction, but really not much considering interest rates. Private business investment in plant and equipment has been strong despite the high interest rates for a number of reasons.

OVERVALUATION OF U.S. DOLLAR

The major effect of the budget deficit and the high interest rates has, rather, to date been on the international sector of our economy. The high U.S. interest rates and other factors have led to a massive overvaluation of the U.S. dollar abroad. The dollar is probably 35 to 40 percent overvalued relative to what it would be, what would be consistent with the approximate balance in our international payments.

U.S. TRADE DEFICIT

The U.S. trade deficit, a very modest number in 1981, rose to about $110 billion in 1984 and in 1985 is going to be even larger.

The mirror image of the massive U.S. balance of payments deficit is an equally large net inflow of foreign capital and savings into the United States. The addition of those foreign savings to the pool of U.S. domestic savings is now indirectly financing about half of the Federal budget deficit.

So instead of adjusting to the huge Federal borrowing with an increase in private domestic saving or a decrease in domestic investment, the United States has adjusted through running a huge balance of payments deficit and borrowing staggering amounts from abroad.

EFFECT OF TWISTING STRUCTURE OF U.S. ECONOMY

What are the consequences of this twisting of the structure of the American economy? In the first place, it substantially penalized our most dynamic industries, our export industries. Second, it substantially exacerbated the already difficult problem of the import competitive industries. But most importantly, for the long run, we are reducing our overseas investment and piling up foreign debts. So the Nation will receive a smaller flow of income from abroad and simultaneously have to pay debt service on our foreign debts. The future growth in American living standards will thereby be depressed.

LONG-TERM EFFECTS OF DEFICIT

What about the longer term? Granted that the impact of the budget deficit to date has principally been in the international sector. What is likely to happen in the years ahead?

Well, the most likely scenario is foreign investors aren't going to continue to finance U.S. budget deficits indefinitely. Ultimately, probably later rather than sooner, but ultimately, foreign savings inflows will begin to shrink.

When that happens, the demand for dollars on the part of foreigners will decline, the value of the dollar will begin to fall, and after a lag the inflow of foreign capital into the United States will begin to dry up.

The Fed will have to engineer then another large rise in interest rates to crowd out domestic investment in order to make room in a noninflationary way for the large Federal borrowing that will be going on year after year.

Foreign capital, therefore, as it stops coming into the country, will generate a rise in interest rates and a squeezing out of domestic investment.

There is an alternative scenario which I don't think is likely but could happen if foreigners continue, surprisingly, year after year, to pour in the foreign savings, in which case U.S. interest rates won't have to rise substantially since U.S. savings will continue to be supplemented by foreign savings.

But the annual debt service on those foreign debts will continue to pile up year by year, obligating us and succeeding generations to make ever larger payments abroad out of our national income.

EROSION OF FUTURE U.S. LIVING STANDARDS

It gives us a Catch-22 situation. On either of those scenarios, the continuation of huge budget deficits will lead neither to catastrophe nor to crisis but a gradual erosion of U.S. living standards. In scenario one, foreigners withdraw the inflow of savings, domestic investment in United States shrinks, our productivity growth slows and U.S. living standards are reduced. If, on the other hand, foreigners sustain the inflow of savings, the debt service to foreigners will steadily mount and U.S. living standards are reduced for that reason.

INTERNAL ARITHMETIC OF LARGE BUDGET DEFICITS

Finally, we have to worry about the internal arithmetic of large, continued budget deficits. Chairman Penner has expressed that very well. The basic proposition is that every year you go with $200 billion deficits and 9 percent interest rates, you add $18 billion to annual interest payments on the debt; in 2 years it is $36 billion; in 3 years it is $54 billion. So if you wait 3 years to do anything about it, you are throwing away the first $54 billion of the tax increase you are going to need anyway to do something about it.

And those unnecessary tax increases that are going to come about ultimately as debt service mounts also are going to mean reduced living standards because of what they do to the efficiency of the economy.

Let me turn very quickly to my final point, that to cut the deficit by the necessary large amount, spending cuts alone aren't going to be sufficient, especially if the spending cuts exclude Social Security and defense.

AMOUNT DEFICIT SHOULD BE REDUCED

How much should the deficit be reduced? Outside of recession and near-recession years, budget deficits in the United States averaged less than 1 percent of GNP during the last 3 decades, 1952 to 1981. The net savings of the U.S. economy is only 8 to 9 percent of GNP. So as a minimum, we should aim to get the projected $250 billion budget deficit for 1988 down to the range of $70 to $80 billion, to 1½ percent of GNP, on the way toward balance by 1990.

In order to reach this target, it is going to be necessary to take budgetary action that would by 1988 amount to about $125 billion a year in spending cuts and tax increases. Such a cut can't be achieved, I don't think—as a matter of fact, I am sure, Mr. Chairman—solely by cutting spending, and especially not by confining most of the spending cuts to civilian programs outside of Social Security.

AREAS OF FURTHER SPENDING CUTS

There are components of a nondefense budget where further spending cuts can and should be made. Some of the proposals advanced by the administration made very good sense. But you can't look at this segment of the budget as the sole or even pricipal source of reaching the necessary deficit reduction target.

These programs have already been cut substantially over the past 4 years. The numbers below show what has been happening to Federal civilian spending outside of Social Security and Medicare as a percent of GNP. From 1940 to 1965, they ranged between 6.5 to 7.5 percent of GNP. By 1980 they went up to 10 percent. And already the Congress has acted in a short space of the last 6 years to bring them down so by 1988, with no further cuts, they will be back down to where they were before Lyndon Johnson got going on his Great Society program.

If the administration's program cuts should go into effect, all of them, civilian spending outside of Social Security and Medicare, will be down to a share of our Gross National Product lower, much lower, than at any time in the past 45 years.

Indeed, if all of the cuts proposed by the administration were nevertheless accepted, the remaining budget deficit in fiscal 1988 would still amount to $180 billion or more on the basis of the new CBO estimates released today. Even if you then added to these cuts large reductions in defense spending of say $30 billion a year, you would still fall far short of a desirable deficit reduction target.

An economically defensible and politically feasible program to reduce the budget deficit by $125 billion, before interest savings, by 1988, will in my judgment require that all elements of the budget be involved—taxes, defense and Social Security.

Simply to give some sense of the magnitudes involved, on page 17 I lay out an illustrative package, but not meaning to put any particular weight on that particular mix of proposals.

CONTINUED DEFICITS DAMAGE FUTURE ECONOMIC WELL-BEING

In conclusion, Mr. Chairman, the most threatening aspect of this budget deficit is that the damage it does is not immediate and critical and obvious. The recovery will most probably continue. Inflation will most probably stay low. While real interest rates are high by historical Standards, very high, we have learned how to tolerate them. The usual political motivations for taking the necessary painful actions are absent.

Yet in the long run the deficit is very dangerous indeed to the Nation's economic well-being. The deficit acts not like cyanide but like arsenic. Better yet, we are like the heavy cigarette smoker. The poisonous effect is slow and gradual and until very late in the game unnoticed. A few more packs of cigarettes can't hurt. I say that as a reformed smoker. [Laughter.]

Great Britain did not slip to a distinctly inferior position through some grand crisis or convulsion. The slippage did not principally show up in terms of inflation and unemployment. Rather, it was a long, gradual process of eroding productivity growth and living standards. But the cumulative damage was very severe.

Most countries do well in handling a crisis, Mr. Chairman. What really takes maturity is the willingness to adapt painful measures not to cure the immediate problem but to forestall future problems. How well we face up to this current budget problem will constitute I think one of the severest tests of political maturity this country has ever faced.

Thank you, Mr. Chairman.

PREPARED STATEMENT

Chairman HATFIELD. Thank you very much, Professor Schultze. You are both very extraordinary gentlemen with very outstanding testimony. Your prepared statement will be inserted in the record at this point.

[The statement follows:]

# PREPARED STATEMENT OF CHARLES L. SCHULTZE

SENIOR FELLOW

BROOKINGS INSTITUTION

Mr. Chairman and Members of the Committee:

Thank you for asking me to testify before your annual economic overview on the nation's economic situation, especially as it relates to the President's 1986 budget submission. I am submitting my testimony in the form of a detailed outline, which I hope, will reduce your reading time.

I. Introduction:

A. Let me summarize the two points I want to make in this testimony:

* First, the damage done to the American economy by a continuation of the huge budget deficit now in prospect will be subtle, indirect, and gradual, not obvious, direct, and immediate. With a little bit of luck it is quite likely that we can continue to enjoy moderate economic growth and low inflation for some time to come, even if nothing is done about the budget deficits. The damage done by the deficits will come in the form of gradual changes, which will slowly erode our living standards; gradually falling productivity growth, growing payments to foreigners to service our mounting foreign debt, and unnecessarily high taxes to pay interest on the swelling federal debt. Ironically the worst thing about the budget deficits is that they may not produce an obvious crisis. If they did, you could get the necessary consensus to eliminate them.

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- Second, a hard assessment of budget numbers and political reality argues that any successful large-scale assault on the deficit must include all major elements in the budget: taxes, defense spending, and social security, as well as the other civilian programs of the government. An attempt to concentrate only on the last of these four elements, as the President's budget does, cannot succeed.

B. Background: Size of the deficit. If nothing further is done to reduce the deficit:

- it will amount to $215 billion in 1985 and 1986, $250 billion in 1988 and rise to $300 billion by 1990;
- federal borrowing will thus remain at about 5 - 5-1/2% of GNP into the indefinite future: this in a country whose net saving outside the federal sector averages only 8 to 9 percent of GNP;
- these forecasts are based on the Congressional Budget Office estimates; they are more realistic, especially with respect to future interest rates, than are the Administration's projections (the Administration unrealistically projects that short and long-term interest rates despite large remaining deficits, fall to the range of 5-5-1/2 percent by 1990);
- but it really doesn't make much difference which estimate you use; in either case the projections show that the "current services" deficit will continue to be huge.

II. In the next several years, and perhaps for longer, the deficits are not likely to bring on either inflation or recession

A. To demonstrate this, it is necessary to start with a few words about the policy of the Federal Reserve.

B. The Federal Reserve now has two principal objectives:

1. Faced with the huge and continuing pump-priming stimulus from the federal budget deficit, the Fed's principal objective is

an antiinflationary one--to keep a lid on the growth of national spending and output. It will do whatever it feels it has to by way of tight money and higher interest rates to prevent an excessively rapid growth from overheating the economy and generating new inflationary pressures. The Federal Reserve's commitment to this objective was amply shown in May 1983, when only five months into the new recovery, it began to tighten monetary policy and push up interest rates. Unprecedentedly early restraint.

2. But, the Fed also has no desire to see another recession. Unlike 1981-82 it will not deliberately put the economy through the wringer of another recession in order to get inflation down further. So long as inflation remains moderate--as it shows all signs of doing--the Fed will not stand by and watch economy go into recession.

   - If it appears that monetary restraint has gone too far, that economic growth is slowing too much--as apparently happened this fall--the Fed will move to ease monetary policy, lower interest rates, and correct its mistakes--as it did last fall and early winter.
   - Real interest rates are still so high,--even after recent easing--that the Fed has very large scope to use monetary policy to correct any mistake or to offset any softening in economy; more so than usually, the Fed is now in a good position to provide counter-recessionary assistance for the economy, should that be necessary to avert a recession.
   - In short, with one possible exception that I will talk about later, the Fed will not deliberately pursue restraint to point of recession; it can and will act to avoid any serious recession;

--we could have several quarters of very slow growth,

--but--subject to the one exception--we are unlikely to have recession in the near future.

C. The upshot of this is that the large federal deficits, even if left unattended, are not likely in the next several years to generate either recession or inflation

D. Nevertheless, deficits will have very damaging long-term consequences for U.S. economy

III. Structural damage to the U.S. economy caused by the budget deficit: 1. The last two years

A. For the past several years we have been continuing and will continue to witness, a clash of two opposing forces:

- Large upward stimulus to some sectors of U.S. economy from the budget deficits;
- Substantial restraint on other sectors of the economy from Fed's high interest rates;

B. The net result to date has been an overall recovery of about average speed, but with a major twist that penalizes interest sensitive sectors of the economy.

- The Fed has been determining the overall speed of recovery and the level of GNP. The budget deficit has had its effect in determining the internal structure of the American economy.

C. Another way of looking at the same phenomenon:

- federal borrowing has grown to 5%-5-1/2% of GNP
- given the Fed's objective of preventing excessively rapid recovery, something else had to give; 5% of GNP had to be squeezed out of other interest-sensitive activities by the high interest rates. This change in structure will have damaging long-term consequences for the economy.

D. There are only three possible routes by which higher interest

rates can crowd out private activity, to make room for federal borrowing of 5 % of GNP:

1. An increase in private saving (i.e., a decrease in consumption) to finance the extra federal borrowing; or
2. A decrease in interest-sensitive private spending
   - 2A. Lower housing construction,
   - 2B. Lower business investment; or
3. An inflow of saving from abroad: i.e., lower exports and higher imports, leading to an inflow of foreign capital and savings into the U.S.

E. Surprising fact about the last two years is that most of the consequences of combining large deficits and tight money have been felt in the foreign sector, i.e., route #3 above:

1. We have had little increase in savings (as a share of GNP) elsewhere in the American economy:
   - corporate retained earnings as a percent of GNP have risen a little, due to the 1981 tax cut
   - state and local governments have been running some their surpluses (principally, in the pension funds for their own employees)
   - personal saving has not increased
   - altogether, an optimistic assumption is highly unlikely that any more than 1/2 to 1% of the 5% of GNP absorbed by federal borrowing came from increased private saving
2. There has been some reduction in housing construction as a share of GNP, but not very much compared to the same stage of other business cycles.
3. Surprisingly, private business investment in plant and equipment has been strong despite the very high interest rates; no "crowding out" to date:
   - partly due to the investment incentives provided in

the 1981 depreciation liberalization

- partly due to large and unexpected decline in the relative prices of machinery and equipment, making it cheaper to invest. (Ironically the cause of this is the overvalued U.S. dollar and the flood of lower priced imports of foreign machinery and equipment)

F. Major effect of budget deficits and high interest rates has been on international sector of the U.S. economy:

- High U.S. interest rates, (not the only reason) led to massive "over valuation" of U.S. dollar abroad; the dollar is probably 35% to 40% overvalued relative to what would be consistent with approximate balance in our international payments;
- Exports cut; flood of imports into U.S.;
- 1981 U.S. trade deficit $28 billion; 1984 deficit $108; 1985 deficit even larger;
- Mirror image of massive U.S. balance of payments deficit is an equally large net inflow of foreign capital and savings into the U.S.: liquidation of U.S. assets--increase in U.S. liabilities;
- Addition of foreign savings to the pool of U.S. domestic savings is now indirectly financing 50% of the federal budget deficit;
- Thus, instead of adjusting to the huge federal borrowing with an increase in private domestic saving or a decrease in domestic investment, the U.S. has adjusted through running a huge balance of payments deficit and borrowing staggering amounts from abroad.

G. Consequences of this "twisting" of the structure of economy:

1. To date, inflow of foreign saving has "sheltered" U.S. private investment from the effects of the large increase in federal borrowing: foreign savings supplemented U.S.

savings so domestic investment didn't have to be significantly crowded out.

BUT,

2. This has substantially penalized our most dynamic industries--the export industries; e.g., in the 1970s the U.S. was becoming a major net exporter of capital goods--by the end of 1984 that trend had been sharply reversed--25% of U.S. business investment in durable equipment now comes from abroad; foreign markets for our high tech industries sharply curtailed.

3. We have substantially exacerbated the already difficult problem of import-competitive industries

   - distorting the pattern of investment in U.S. industries;
   - generating a large rise in protectionist pressures

4. For the long run, we are reducing our overseas investments and piling up foreign debts; the nation will receive a smaller flow of income from abroad, and simultaneously have to pay debt-service on our foreign debts; the future growth in American living standards will be depressed.

   - the inflow of foreign saving has enabled the U.S. both to finance a large federal deficit and to keep up the level of private business investment high;
   - but, much of the fruits of that "sheltered" investment, in terms of increased output and income, won't go to U.S. citizens but will have to be used to pay debt service to foreigners.

IV. Structural damage to the U.S. economy caused by budget deficit:

2. Future structural changes and their consequences

A. Several alternative scenarios for the future:

1. Most likely scenario: Foreign investors will not continue

to finance U.S. budget deficits indefinitely; foreign savings inflow will begin to shrink:

- Currently foreigners are acquiring $100 billion or more per year in dollar denominated securities; as time goes on, their portfolios get more and more top heavy with dollar assets and the risks they run in case the dollar declines get larger and larger.
- Eventually, therefore, the demand for dollars on the part of foreigners will decline, the value of the dollar will gradually (?) begin to fall and, after a lag, the inflow of foreign capital into the U.S. will begin to dry up.
- With foreign savings no longer supplementing the limited flow of U.S. domestic savings, the 4-1/2 - 5% of GNP borrowed by the federal government will have to to be diverted from U.S. domestic investment in housing and business capital formation.
- The Fed will have to engineer another large rise in interest rates to crowd out domestic investment in order to make room, in a noninflationary way, for the large federal borrowing that will be going on year after year.
- With substantially lower domestic investment, the longer-term growth of the U.S. economy will be slowed; improvements in our future living standards and those of our children will be seriously impaired.

2. A less likely but still possible scenario:

- Foreign capital continues for a very long time to flow into the U.S. in large amounts, despite the increasingly sizeable accumulation of dollar assets in hands of foreigners;
- Domestic investment continues to be sheltered; U.S.

interest rates don't have to rise substantially, since U.S. savings continue to be supplemented by foreign savings;

- But the annual debt service on foreign liabilities continues to pile up year by year, obligating us and succeeding generations to make ever larger payments abroad out of our national income.

3. Note that on either of these scenarios, the continuation of huge budget deficits leads neither to catastrophe nor to crisis, but to a gradual erosion of U.S. living standards:

- Scenario 1: Foreigners withdraw the inflow of savings; domestic investment shrinks; U.S. productivity growth slows; U.S. living standards reduced;
- Scenario 2: Foreigners sustain the inflow of savings; debt service to foreigners steadily mounts; U.S. living standards reduced.

V. Other long-term damage from the budget deficit: 1. The internal arithmetic of large, continued deficits

A. Some simple "deficit arithmetic":

- A one year deficit of $200 billion adds $200 billion to the level of federal debt on which we have to pay interest; at average 9% interest rates that adds a continuing $18 billion a year to the stream of interest payment.
- Two years of $200 billion deficit adds $400 billion to the national debt and $36 billion to annual interest payments; three year adds $54 billion to this stream of interest payments.
- Thus, by postponing action on the deficit for 3 years the first $54 billion of the tax increase needed to deal with the deficit would be wasted--thrown away to pay for the

added interest burden that inexorably accumulates by waiting.

B. The ratio of federal debt to GNP, which steadily declined from over 100 percent at the end of World War II, to a range of 25-30 percent in the late 1970s, is now rising again, and rising sharply. Moreover, the growing federal debt/GNP ratio can't be financed at interest rates of 2 to 4 percent, as it was in the 1940s and 1950s.

C. By 1990, if nothing is done to reduce the deficit, 45 percent of personal income taxes each year will go simply to pay interest on the debt;

D. There is a loss to the nation from unnecessarily high tax burden by way of reduced work incentives to work, save, invest, and take risks;

—the burden is far less than the "supply siders" would have you believe;

—but a loss nevertheless.

E. By failing to raise taxes (and cut spending) now, we will simply have to raise them even higher in the future; we don't avoid a tax increase by waiting—we simply postpone it and make it worse, when it does finally come.

In sum: Continuously siphoning off 5 - 5-1/2% of GNP into federal borrowing has depressed and will continue to depress future U.S. living standards in three ways:

1. Initially, it has generated large increases in debt owed to foreigners, so that part of any future increase in U.S. productivity will have to be paid abroad in debt service rather than being available to increase U.S. living standards.

2. Later, to the extent foreign capital inflow shrinks, the deficits will then squeeze out U.S. domestic investment and thereby lower the growth of U.S. living standards. To the extent the foreign capital inflow continues American living

standards will suffer in a different way as we pay abroad the mounting burden of debt service.

3. Finally, continued rapid growth in the ratio of federal debt to GNP, inexorably generates an increasing tax burden for future taxpayers--which adds its contributions to the growth-depressing effects of the budget deficits.

VI. A final word on the economic consequences of the deficit--one possible scenario by which the deficit would lead to a short-run crisis

A. As indicated earlier, in the most likely scenarios the damage the budget deficit does is not short-run, direct, and of a crisis nature; it is subtle, long-term, and gradual. There is, however, one scenario--not in my judgement a likely one but still possible--through which leaving the budget deficit unattended could lead to a serious short-run crisis.

B. Earlier in discussing Fed's objectives, I said that so long as inflation pressures are not renewed the Fed has no desire to put us through the wringer of recession and would actively work to avoid it.

C. But suppose, when the dollar finally does start to decline, it does so not gradually but with a rush; speculative forces take over; the dollar plummets.

D. The sharp rise in import prices, accompanying the plunge of the dollar, would directly and indirectly lead to a sizeable temporary jump in U.S. inflation rates.

E. To make sure that initial surge of inflationary pressure did not lead to a permanent rise in U.S. inflation (e.g., as higher consumer prices led to higher wage increases, and then to a new wage-price spiral) the Federal Reserve might indeed be willing to tighten monetary policy severely and put the economy into a recession, as the only way to squelch the

incipient inflationary pressure from sharply rising import prices.

F. In that possible—but I think not probable--situation, the deficit could, in addition to long-term damage, wreak serious short-term harm.

VII. To cut the deficit by the necessary large amount, spending cuts alone will not be sufficient, especially if the spending cuts exclude social security and defense

A. By how much should the deficit be reduced?

1. Outside of recession and near-recession years, budget deficits in the U.S. averaged less than 1 percent of GNP during the three decades 1952-1981.

2. The net saving of the U.S. (before taking account of the federal budget) is only 8 - 9 percent of GNP. At a minimum we should aim to get the projected $250 billion deficit for 1988 down to the range of $70 - $80 billion, i.e., to 1-1/2 percent of GNP--on the way towards balance by 1990.

B. In order to reach this target it would be necessary to take budgetary actions that would, by 1988, amount to about $125 billion a year in spending cuts and tax increases (taking into account a conservative estimate of savings in interest payments from the lower debt and lower interest rates).

C. Such a cut cannot be achieved solely by cutting spending, and especially not by confining most of the spending cuts to civilian programs outside of social security, as the Administration has proposed.

1. There are indeed components of the nondefense budget, outside of social security, where further spending cuts can and should be made. Some of the proposals advanced by the Administration made good sense.

2. But you cannot, as the Administration does, look at this segment of the budget as the sole, or even principal, source of reaching the necessary deficit reduction target. These programs have already been cut substantially over the past four years. The numbers below show what has been happening to federal civilian spending, outside of social security, Medicare, and interest on the debt, as a percent of GNP:

| | | | |
|---|---|---|---|
| 1940: | 7.5% | 1965: | 7.0% |
| 1948: | 7.0% | 1980: | 10.2% |
| 1955: | 6.5% | 1988:A | 7.3% (no further cuts) |
| 1960: | 7.5% | 1988:B | 5.8% (Administration budget) |

- i.e., as a share of GNP civilian spending, outside social security and Medicare, has already been cut to where it was before LBJ launched his Great Society program; the Administration's proposals would cut them back to a much lower share of GNP than they were at any time in the last 45 years.
- total spending in all of these civilian programs will amount to only $325 billion in 1988; you can't eliminate a $250 billion deficit out of a $325 billion kitty.

3. If all of the cuts proposed by the Administration were, nevertheless, accepted, the remaining budget deficit in fiscal 1988 would still amount to $160 billion or more given realistic estimates of interest rates and economic growth.

4. Even if you then added to these cuts large reductions in defense spending of, say, $30 billion a year, you would still fall far short of a desirable deficit reduction target.

D. An economically defensible and politically feasible program to reduce the budget deficit by $125 billion (before interest savings) by 1988 will, in my judgement, require that all elements of the budget be involved including taxes, defense, and social security.

E. The following package is an example:

| | fiscal 1988 deficit reduction (billions of $) |
|---|---|
| 1. Disallow cost-of-living increases for one year in all indexed and related programs, including social security (exempt means tested programs at modest cost); and freeze Medicare reimbursements for one year | $20 |
| 2. One year freeze on all discretionary programs, plus $10 billion in specific program cuts | $20 |
| 3. One year freeze in inflation adjusted defense appropriations (resuming 5% real growth in 1987) | $30 |
| Total spending cuts | $70 |
| 4. Required amount to be raised by taxes | $55 |
| Total | $125 |

Taking into account the savings in interest payments on the debt that would be forthcoming, such a program would reduce the deficit to the neighborhood of $70-$80 billion by 1988.

VIII. Conclusion

The most threatening aspect of the budget deficit is that the damage it does is not immediate, critical, and obvious. The recovery will most probably continue; inflation will most probably stay low; while real interest rates are very high by historical standards we have learned to tolerate them. The usual political motivations for taking the necessary painful actions are absent.

Yet in the long run the deficit is very dangerous indeed to the nation's economic well-being. The deficit acts, not like

cyanide, but like arsenic. Or better yet, we are like the heavy cigarette smoker. The poisonous effect is slow, gradual, and until very late in the game unnoticed. A few more packs of cigarettes can't hurt. Great Britain did not slip to a distinctly inferior economic position through some grand crisis or convulsion. The slippage did not principally show up in terms of inflation and unemployment. Rather it was a long, gradual process of eroding productivity growth and living standards. But the cummulative damage has been severe. (The British problem was not principally its budget deficits. But the process of slow damage was similar.)

Most countries do well in handling a crisis. What really takes maturity is the willingness to adapt painful measures not to cure an immediate problem, but to forestall future problems. How well we face up to the current budget problem will constitute, I think, one of the severest tests of its political maturity this country has faced.

## General Questioning

### USE OF ADDITIONAL REVENUES FOR COMBATTING DEFICIT

Chairman Hatfield. Let me pose a question and I would like to have each one of you respond to it, if you will.

I have heard the question referred to in your testimony specifically that has confronted us for quite some time. That is the question of additional revenues to meet this deficit problem.

Assume, first of all, that the Congress has addressed this problem with courage and determination, and we, as you know, are moving primarily on the spending side of the problem at this time. We have done everything politically feasible to reduce the spending level of the Government, in all areas; defense, nondefense, even some COLAs; and say then we still cannot see a realistic elimination of the deficit down the road in the outyears, that it still seems to be there, any way you compute it, in that situation, and the President has made it very clear that he opposes any tax increase. So let me give you another assumption. Let's not assume that we are going to just supefimpose upon the current tax structure or the current tax rate system additional revenues but we are going to abolish the tax system and reconstruct one on an equitable, enforceable basis, which will in addition to that character bring us in additional revenues to help meet that deficit.

Now, I am not suggesting what kind of tax system that would be, whether it is sales tax, Fed, or some way we broaden the tax base and incorporate more taxpayers than what we have now.

I would like to get at the fundamental question that has bothered me because at the current time, as we see these rising payments on the national debt and the deficit continuing, it is forcing the Government to go into the money market and borrow money from private markets.

Now I want to know the economic difference between financing government spending programs through taxing versus financing government spending programs through Federal borrowing. I would like to know who pays the cost of borrowing and who pays the cost of taxing and what are the risks in either or both, or any other comments you wish to make on that basic question.

### DEFICIT FINANCING FROM CONSUMPTION AND INVESTMENT

Mr. Weidenbaum. One distinction I would make is how much of the financing of the deficit comes out of consumption and how much comes out of investment. It strikes me that when government borrows, it competes head on with investment. That I find a good reason, adequate among other reasons, to curtail government borrowing.

When you get down to raising taxes, of course, it depends on what sort of tax system you devise. You can devise one that reduces consumption. You can, on the other hand, without difficulty, find tax systems that now not only reduce investment but reduce incentives to produce in the way that you have a lower rate of economic growth. In effect, you defeat the purpose. So that this is why So many of us who have looked at the details of the budget conclude that there are so many soft spots, like the one example I cited.

Now I went through the 1982 or 1983 Senate Public Works report and I came across over a billion dollars of projects where the benefit-cost ratio was as close to 1.0 as you could get, using an interest rate that was so far below the Treasury's borrowing costs you knew if you did a realistic calculation, here was a billion dollars of projects where the cost to the country was much greater than the benefits.

Well, I hate to see either the borrowing for that or taxing for that. I think either way you can get a lower rate of economic growth, a lower living standard, than if you didn't spend that billion dollars in the first place.

RAISING MONEY THROUGH TAXES OR BORROWING

Mr. SCHULTZE. It seems to me there are really, I will say, two big criteria you want to use in looking at your question. That is raising the money through taxes or through borrowing.

The two criteria I think are, first, what does it do to the growth and efficiency of the economy—I will use that as one word, growth and efficiency—and what about fairness? We are interested in both of them.

With respect to taxes, no matter how you raise taxes, they will have some effect in reducing growth and efficiency. But in my judgment, if they are carefully levied, not very much. They will have some. You cannot raise taxes without penalizing people for working in the sense that every hour you work, you really get less for it because the Federal Government takes some of it. Normally it is very hard to do without penalizing people on their savings and interest income. You can do it to some extent, but it is very hard to do.

In my judgment, on a scale of one to a hundred, raising the money that way might have an economic efficiency cost of 10. When you borrow, however, you have an economic growth and efficiency cost of something very, very much higher than that because normally, in the normally prosperous economy, that is going to soak up savings that would otherwise have gone to business investment. And almost all of that is going to come out of growth-producing activity. Or you are going to borrow it from abroad, which has almost the same effect because you have that huge debt service to pay.

On a scale of zero to a hundred, I would say that if taxes, even well-designed taxes, cost you 10, the borrowing will cost you 80. The numbers don't mean anything. What it fundamentally says is what borrowing does is it attracts savings. That comes either out of investment or you borrow it from abroad. Either way you are hurting your living standard almost dollar for dollar in some sense. Whereas when you raise it by taxes, carefully, you will affect efficiency but not as much.

FAIRNESS IN TAXING

The next question is what about fairness? Well, you can deliberately, at least in theory, design a tax system to levy the burden where you want to levy it. With borrowing, fundamentally who pays when you borrow? Who pays when you borrow is future generations. Who gets the lower living standard?

So therefore, when you tax, I think if you do it carefully, rather than borrowing, you have a better chance of being fair, particularly among generations. You have a smaller negative impact on growth and efficiency. Borrowing you are less fair and I think you have more of an impact on growth and efficiency.

Now, there are certain occasions where this gets reversed, but basically with the kinds of conditions the United States is now facing in the foreseeable future, I think what I have said is in the right ballpark.

### UNENFORCEABILITY OF PRESENT TAX STRUCTURE

Chairman HATFIELD. There is another question that comes to my mind as you discussed this, of course, in terms of the impact it will have on production, efficiency, and so forth. Here a week or so ago the head of the IRS wrote a guest editorial or article in The Washington Post in which, as I recall, and refresh my memory, I think he used the figure $90 billion we were losing from our tax structure that had not been collected, or people were escaping that amount of obligation, collectively, to our government, which reflected again on the complexity, and what I call the unenforceability of the present tax structure.

We are all aware of that figure that has been tossed around of that $100 billion underground economy, in part perhaps lost out of the complexity again of our tax structure. We hear good about the Grace Commission and all the inefficiencies it has corrected to save money, as in the case of the Hoover Commission.

Is this not another dimension to that same thing? And one fourth factor let me add. When the Secretary of the Navy tells me there is a certain producer of weaponry systems for the Navy who has not paid any corporate income tax for 25 years, legally, and here other corporations are paying maybe a 30 percent tax or 25, or whatever it might be, aren't they then mechanically restructuring and rebuilding a tax structure? Would you say the dollars are there to really move toward that abolition of a deficit, just if we could even enforce the current tax structure? A major part of that deficit could be reduced, but without impinging so much on the efficiency and productivity and investment taxes and all of these other factors.

It seems to me there is a third approach here somehow of doing more than tinkering but tightening up. I agree with Professor Weidenbaum when he talks about the subsidies and some of these things we could do. It wouldn't, I think, impact upon the efficiency of our productive system, would it? Or it would have a more minimal impact?

### TAX RATE PLANS

Mr. SCHULTZE. Let me try my hand starting on this one. First, I do not think that simply by enforcing the current tax law more rigorously you are going to get a lot more money. Now, you could probably give the IRS some more money and they could bring in more than it costs you. But there is kind of a limit to the intrusiveness that the American people are going to allow. You may not be at the limit, but you can't go a lot further.

Second, however, you won't get this free, but it seems to me that the administration or at least the ex-Secretary of the Treasury and his people have produced a marvelous instrument, I think, for moving in that direction. Maybe it is the role of Republican administrations to recognize Red China and produce liberal tax documents. I think it is a great document. It has its problems.

If I had to do it, which I don't, my own favorite approach to this would be to adopt that plan with tax rates at the range of 17. If you put the tax rates at 17 to 39 percent, mind you, still well below what we now have, and did an appropriate adjustment on corporate tax, you would raise $60 billion by 1988. That is a fair and I think much more uniformly distributed tax, with lower rates than we now have.

Mr. WEIDENBAUM. I have a somewhat different view. I don't think that there is a crying need for reducing income tax rates. We all like to pay a lower set of tax rates. But the fact is when I looked at the Treasury, I see a fundamental reduction of income tax rates to be made up in good measure by reducing incentives for investment.

Looking at the economic and fiscal problems facing the country, I find it hard to justify putting that on top of the priority list.

Given all of its shortcomings, I find that it is a far more urgent need to get the deficit down, which gets me back to mainly the expenditure side, rather than to open up a subject which really, to the average citizen, is tax reduction. That is a carrot we ought to dangle later in the process.

But you don't have to wait. The instance that the Secretary of the Navy talked about results from the way in which the current tax code treats differently the expenses of defense, in terms of timing, and the expenses of defense contracts and the revenues and profits under defense contracts. You could change that provision of the code. You can clean that up without waiting for a fundamental revision of the tax structure.

Chairman HATFIELD. Professor, let me ask you one more question on that line you brought up about this tax incentive.

1981 TAX REDUCTION PACKAGE

Do you think if we could have isolated, and you can't do this, this is purely a hypothetical circumstance I am going to describe, if we could have isolated or separated the politics, total politics, partisan politics, from the tax reduction package this administration got enacted in 1981, so that the Democrats could not say well, this is just a Republican package to target tax reductions in the business corporate world as incentives for employment and increased production, and therefore we added what I consider that odious Roth-Kemp proviso in order to deal with the politics of it. And $200, or whatever it might have been, to the average American family, in my view, did not reflect itself in new investments and could be frittered away pretty quickly in paying off old debt and so forth.

But be that as it may, that is my personal opinion. It seems to me if we had to put a tax reduction package together that targeted on the corporate and business community of this country, we would have been far

better off in dealing with the deficit now than adding that across-the-board personal income tax of Roth-Kemp that they tell me now is worth two-thirds of the present deficit.

Mr. WEIDENBAUM. It is ironic, my memory says that Dr. Schultze in his administration toyed with a tax proposal of the type you just described.

I think, and this is hindsight—you hopefully learn from experience—that the clean tax bill that the administration sent up in 1981 may have, yes, been tilted more to consumption and less to investment than I would like, but we could have lived with that. It was all of the add-ons, both the sweetners, including the long-term sweetners on the tax side as well as literally sweetners, sugar subsidies and things like that, on the spending side, to develop enough support here on the Hill for the entire package and perhaps one of the overtures by the other side of the aisle for making the third-year tax cut contingent on progress, on reducing the deficit.

Therefore, having just a 3-year, not a permanent, tax reduction, having a much more modest tax program, with strong bipartisan support, in retrospect might have been the greater cause of wisdom.

Chairman HATFIELD. Let the record show I voted against Roth-Kemp every time it stood on its own. I had to support the total package because I was looking for the targeting to do the things in our economy, which I think did do a great deal for the economy. But I think we are now paying for the Roth-Kemp in some of our struggles at the moment. But that is beside the point.

Mr. SCHULTZE. I think there are technical internal problems with ACRS, but they could be straightened out, and I think basically you are right. I would like to make two points on that.

One, there is a very fascinating table at pages 152 and 153 and 154 of the older CBO book, not the new one that came out today but the one that came out about a month ago, which simply documents what the legislative tax, defense appropriations and nondefense spending changes have been since 1981. The Congress, you know, on spending hasn't done all as bad a job as people talk about. I am getting to your point in a moment.

Defense spending is up in 1986, $41 billion above where it would have been under the Carter policies. The Congress has cut nondefense spending by $63 billion. So you have more than offset the defense spending. That has given you about a $20 billion extra kitty. That is in 1986. But the tax cut, after TEFRA, after all the adjustments, is still costing us $130 billion a year.

I think you are exactly right, we would still have a deficit problem, but it would be much, much smaller and we wouldn't have had the interest on the debt as much and we would be in much better shape.

My next point, and this is where I guess I disagree with Murray Weidenbaum some, substantively and certainly politically there just isn't that much room to cut any more, I do not think, in those civilian spending areas. I don't mean there aren't places that couldn't be cut. Of course there are. Again I emphasize even if you accepted every one of

the administration's cuts, you would have a $180 billion budget deficit for the rest of this decade.

Second, if you accepted every one of their cuts, you would have a non-Social Security and Medicare part of the government, that is everything else to Social Security and Medicare, as a smaller share of the economy than it has been in the last 50 years. I ran out of the records in 1940 and didn't look any further. Probably the smallest in the world by far.

Chairman HATFIELD. Would you excuse me while I go vote and let Senator Weicker continue. But I appreciate your responses on that because it does seem to me that we have to realize that this problem is of such magnitude that we can't expect to wake up tomorrow morning and have the same assumptions we started with today because the Budget Committee has just now revised the figure of $51 billion which had been used, as you know, to achieve that 4 percent of the GNP now upward to I believe it is $62 billion. That has happened, so to speak, overnight.

So this is something I think we really have a tiger by the tail, that we have to do something more than just tinkering in and band-aiding a problem here. It calls for major surgery.

SUBMITTED QUESTIONS

Senator Weicker has no questions. We do have some to submit to you from other Senators who have asked to be protected on that and want information from you. So we will submit them to you.

[The following questions were not asked at the hearing, but were submitted to the witnesses for response subsequent to the hearing:]

## Questions Submitted by Senator Hatfield

Q. Dr. Weidenbaum, the President is proposing $313.7 billion in new BA for the 050 Defense functions and about $1.4 trillion in outlays over the next four years.

Many economists and financial analysts have commented that spending of this magnitude might incur deleterious long-term impacts by concentrating enormous resources into such a narrow industrial base.

What is your assessment of the long-term impact of defense spending on the economy, unemployment, interest rates and the economy in general?

A. In my various writings on the subject of defense spending and the economy, I have concluded that defense outlays on balance are more of a drag than a spur to the economy. However, within a reasonable range, the United States can afford whatever amount of defense spending that is considered necessary for our national survival. However, this does not mean that such spending should be justified because of its economic impacts, nor should the Pentagon be given a blank check on the nation's valuable and limited resources. Given the alternative public and private uses for the resources used by the Department of Defense, they need to make a compelling case for their high and rising budgets. Personally, I do not believe that they have done so.

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Q. In its report on deficit reduction options, the Congressional Budget Office declined to discuss the relative merits of $10 billion less defense spending versus $10 billion less domestic spending. CBO feels constrained to leave the debate on such trade-offs to us, the elected representatives.

You are under no such constraint. Are we better off reducing the President's budget by $10 billion in defense spending or $10 billion in non-defense spending?

A. On the relative merits of cutting defense or domestic spending, it is clear that the preferred choice is to cut both areas. The uncritical approach taken toward the military budget in the last four years certainly leaves room for significant reductions. But the task of reducing the deficit simultaneously requires further reductions in civilian outlays.

In any event, the economist in me urges identifying weak spots (marginal programs) in each department and agency, without exception.

Q. Before this committee last week, Mr. Stockman stated that in the absence of deficit reduction measures, federal borrowing will absorb more than two-thirds of all the net private savings available in the U.S. economy.

Do you agree with Mr. Stockman's assessment, and if so, what

are the short and long-term implications on overall economic performance.?

A. Dave Stockman's numbers appear to be accurate, but I believe that the context is too limited. It has become clear in recent years that a large share of federal borrowing can be financed overseas. Nevertheless, such borrowing raises other serious concerns, such as the vulnerability of the United States to foreign financial pressures.

But basically Stockman is correct because the large deficits exert upward pressure on interest rates and do crowd out some potential private activities.

Q. Is the dollar over valued in you mind and if so, what is the economic cost on the U.S. economy?

A. It is not a matter of the dollar being over-valued but rather extremely highly valued compared to, say, five years ago. This upward movement in the value of the dollar in world currency markets has hurt both agriculture and industry in competing against foreign producers. Although I cannot pinpoint the precise effects, it is clear that sustained reductions in the deficit would help to restore the dollar to those earlier relationships to foreign currencies.

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## Questions Submitted by Senator Kasten

### MONETARY QUESTIONS

Gentlemen, a few days ago, Paul Volcker said that he intends to supply enough money and credit in 1985 for the economy to grow at about a 3.5 percent to 4 percent rate. He also indicated that the decline in interest rates would not continue.

Do you think that Chairman Volcker's range for economic growth—and hence monetary growth—is too conservative?

Do you think that a more expansive monetary policy would provide a better chance for maintaining our economic recovery?

A. I do not believe that Paul Volcker's range for economic growth is too conservative. Frankly, I worry about the pressures to get the Fed to expand the money supply more rapidly, as seems to be implied by your question. The preoccupation with growth and the lack of attention to inflation, unfortunately, is the approach that helped to generate the escalating double-digit inflation that characterized the 1970s. This country paid a very high price in 1981-82 in successfully dealing with that situation.

ECONOMIC GROWTH QUESTIONS

Last week, the Commerce Department reported that the economy grew at a rate of 4.9 percent in the last quarter of 1984. That's a full percentage point higher than they had expected. And, despite the forecasts of many "experts," the economy grwe at a rate of 6.9 percent last year. All in all, the economy has grown at about a 6 percent annual rate over the 2 years since the recession which ended in 1982—faster than any upturn since 1951.

The budget resolution for fiscal year 1985 also assumed that the economy would grow slowly. It assumed a rate of 5.4 percent in 1984—a full 1.5 percent less than reality.

The administration has forecast a growth rate of 3.9 percent for the next calendar year.

What are your projections for growth next year?

Do you think the administration's estimate for growth is too conservative?

What steps can and should we take to get a better indicator of economic performance?

A. I am currently projecting 3 1/2 percent real growth and 4 percent inflation for 1985. Under the circumstances, I do not believe that the Administration's estimate for growth is too conservative. The fact is that the Administration's estimates tend to be more optimistic than those of most private forecasters.

I have no quarrel with current indicators of economic performance. I do not favor beheading messengers, whether they bring bring good or bad tidings.

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QUESTIONS SUBMITTED BY SENATOR BUMPERS

REASONABLENESS OF ADMINISTRATION'S FORECAST

You point out in your testimony that most private forecasters are projecting real economic growth of around 3.5 percent for 1986. Yet for 1986, and subsequent years, the administration is forecasting a 4 percent GNP growth rate.

Q. Does it seem prudent and reasonable to you that we base government budgeting on something other than the consensus or "most-likely" case?

A. The Administration's forecast of real growth for 1986, although a bit on the high side, is within the range of estimates prepared by experienced private forecasters. My concern is that, in the years beyond, the Administration's estimates show an unbroken period of high growth, low inflation, and rapidly declining interest rates. I would

consider it more prudent to base projections on more reasonable assumptions.

It might not be a bad idea to adopt the private sector consensus for economic projections as the base for budgeting. That change would help to remove partisanship from that activity.

## MIDCOURSE CORRECTIONS: INEVITABLE? COSTLY?

Something that worries me about these overly optimistic forecasts is that we increase the likelihood of having to make substantial and costly midcourse corrections in a year or two. A case in point was the President's belief in 1981 that we could cut taxes by 25 percent, double defense expenditures, and balance the budget by 1984. The result was that we overshot the mark in 1981 and had to subsequently raise taxes in each of the following years.

Q. Does this sort of erratic fiscal policy bother you?

A. Of course, I would have preferred the results of recent years to have been more favorable. But, as I reflect on the recent past, I find enough blame to extend to both ends of Pennsylvania Avenue and to both sides of the political aisle.

For example, hindsight tell us that the President should have submitted smaller outlay proposals and the Congress should have cut the budget more extensively. Likewise, the budget would have been in better shape if the "clean" tax proposals (personal rate reduction and ACRS only) submitted in early 1981 had been enacted without all the expensive embellishments that were subsequently added.

## PARTIAL INDEXATION: A REASONABLE TRADEOFF?

This year we will begin indexation of income to protect taxpayers from being pushed into higher tax brackets by inflation. In a world of unlimited resources, it clearly would be desirable to protect our citizens from bracket creep. It seems just as clear, at least to some of us, that getting the budget deficit down is desirable.

Q. Against this backdrop, do you think it is reasonable to move toward a partial indexation scheme—something like CPI minus three—in order to make some headway on the deficit and, at the same time, offer some protection to taxpayers from inflation?

A. I have always been concerned about indexation because it tends to insulate voters from the adverse effects of inflation and thus reduces political support for always painful anti-inflationary measures. But I would begin on the expenditure side rather than the revenue side in reducing the extent of indexation -- or at least have them go hand-in-hand.

EDUCATION: THE FORGOTTEN DETERMINANT
OF SUPPLY-SIDE GROWTH

The focus of this administration for the first four years was driven by the desire to stimulate the supply side of the economy by providing incentives for capital investment. At the same time, however, the administration has continually proposed cuts to our social commitment to education. They are once again this year proposing cuts to education, in the name of deficit reduction. At best, this strikes me as penny-wise and pound-foolish. At worst, the proposal to reduce our social commitment to education seems like a grievous neglect of one of the most important determinants of long run productivity and economic growth.

Q. As an economist and educator, do you have any thoughts about the role of education in determining economic growth?

A. As an educator, of course, I am rather partial to the role of education in economic growth. As I noted in my testimony before the committee, even after all the "budget cuts", federal aid for higher education is up in real terms from the 1980 level.

All in all, I tend to take as critical a view of the reality of federal programs for education as for any other purpose. Thus, I quickly confess that I was a strong supporter in 1981 of the notion of tightening loans to college students so as to avoid the possibility of parents (indirectly) investing the proceeds in Treasury bills. I find that still is a desirable approach.

As I look at the array of federal programs in the field of education in relation to the rest of the budget, I conclude -- not that education was cut too much -- but that the rest of the budget was cut too little.

CONCLUSION OF HEARINGS

Chairman HATFIELD. Thank you again. You have been very helpful.

[Whereupon, at 4:05 p.m., Wednesday, February 27, the hearings were concluded and the committee was recessed, to reconvene at the call of the Chair.]

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